

**TEERTHANKER MAHAVEER UNIVERSITY  
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**CENTRE FOR ONLINE & DISTANCE  
LEARNING**



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# **MODULE I**

## **BASIC CONCEPTS**

### **INCOME TAX**

#### **Introduction**

In a Welfare State, the Government takes primary responsibility for the welfare of its citizens, as in matters of health care, education, employment, infrastructure, social security and other development needs. To facilitate these, Government needs revenue. The taxation is the primary source of revenue to the Government for incurring such public welfare expenditure. In other words, Government is taking taxes from public through its one hand and through another hand; it incurs welfare expenditure for public at large. However, no one enjoys handing over his hard-earned money to the government to pay taxes. Thus, taxes are compulsory or enforced contribution to the Government revenue by public. Government may levy taxes on income, business profits or wealth or add it to the cost of some goods, services, and transactions.

#### **DIRECT TAX & INDIRECT TAX**

There are two types of taxes: Direct Tax and Indirect Tax

Tax, of which incidence and impact fall on the same person, is known as Direct Tax, such as Income Tax. On the other hand, tax, of which incidence and impact fall on two different persons, is known as Indirect Tax, such as GST, etc. It means, in the case of Direct Tax, tax is recovered directly from the assessee, who ultimately bears such taxes, whereas in the case of Indirect Tax, tax is recovered from the assessee, who passes such burden to another person & is ultimately borne by consumers of such goods or services.

#### **Difference between direct taxes and Indirect Tax**

Direct taxation is defined as the tax which is directly levied on the citizens of a country. All individuals and business concerns have to pay direct taxes to the government on a regular basis. These direct taxes are calculated on every sources of income that accrues to the business of individual.

On the other hand, the citizens of a country are charged certain levies indirectly as well. These indirect levies are known as indirect taxes. These are the taxes payable on an activity or a commodity. Tax is collected at the time of sale or purchases or rendering of services. Some common examples of indirect taxes are sales tax and excise tax.

**Finance Act:**

Every year, the Finance Minister of the Government of India presents the Budget to the Parliament. Once the Finance Bill is approved by the Parliament and gets the assent of the President of India, it becomes the Finance Act.

**Income-tax Rules:**

The administration of direct taxes is looked after by the Central Board of Direct Taxes (CBDT). The CBDT is empowered to make rules for carrying out the purposes of the Act. For the proper administration of the Income-tax Act, the CBDT frames rules from time to time. These rules are collectively called Income-tax Rules, 1962.

**Circulars and Notifications:**

Circulars are issued by the CBDT from time to time to deal with certain specific problems and to clarify doubts regarding the scope and meaning of the provisions. These circulars are issued for the guidance of the officers and/or assesseees.

**Brief History Of Income Tax In India**

In India, Income tax was introduced for the first time in 1860, by Sir James Wilson in order to meet the losses sustained by the Government on account of the Military Mutiny of 1857. Thereafter; several amendments were made in it from time to time. In 1886, a separate Income tax act was passed. This act remained in force up to, with various amendments from time to time. In 1918, a new income tax was passed and again it was replaced by another new act which was passed in 1922. This Act remained in force up to the assessment year 1961-62 with numerous amendments. The Income Tax Act of 1922 had become very complicated on account of innumerable amendments. The Government of India therefore referred it to the law commission in 1956 with a view to simplify and prevent the evasion of tax. The law commission submitted its report in September 1958, but in the meantime the Government of India had appointed the Direct Taxes Administration Enquiry Committee which submitted its report in 1956. In consultation with the Ministry of Law finally the Income Tax Act, 1961 was passed. The Income Tax Act 1961 has been brought into force with 1 April 1962. It applies to the whole of India including Jammu and Kashmir.

**ASSESSEE [SEC 2(7)]**

“Assessee” means,

- a. a person by whom any tax or any other sum of money (i.e., penalty or interest) is payable under this Act (irrespective of the fact whether any proceeding under the Act has been taken against him or not);

- b. every person in respect of whom any proceeding under this Act has been taken (whether or not he is liable for any tax, interest or penalty) for the assessment of his income or loss or the amount of refund due to him;
- c. a person who is assessable in respect of income or loss of another person;
- d. every person who is deemed to be an assessee under any provision of this Act; and
- e. a person who is deemed to be an 'assessee in default' under any provision of this Act.

E.g. A person, who was liable to deduct tax but has failed to do so, shall be treated as an 'assessee in default'.

### **Deemed Assessee:**

A person who is deemed to be an assessee for some other person is called "Deemed Assessee".

### **Assessee In Default:**

When a person is responsible for doing any work under the Income Tax Act and he fails to do it, he is called an "Assessee in default".

### **Assessment [Section 2(8)]**

This is the procedure by which the income of an assessee is determined by the Assessing Officer.

### **ASSESSMENT YEAR (A.Y.) [SEC. 2(9)]**

Assessment year means the period of 12 months commencing on the 1st day of April every year. It is the year (just after the previous year) in which income earned in the previous year is charged to tax. E.g., A.Y. 2019-20 is a year, which commences on April 1, 2019 and ends on March 31, 2020. Income of an assessee earned in the previous year 2018-2019 is assessed in the A.Y. 2019-20.

### **Taxpoint:**

- *Duration:* Period of 12 months starting from 1st April.
- *Relation with Previous Year:* It falls immediately after the Previous Year.
- *Purpose:* Income of a previous year is assessed and taxable in the immediately following Assessment Year.

### **Income – section 2 (24)**

Income tax is charged on total income of an assessee. Therefore it is highly necessary to understand the term clearly. Broadly speaking income means money or money's worth received from

any definite source with certain amount of regularity. It is a periodical receipt from one's business, land, work, investment etc. in other words it is periodical return received on regular basis. Income includes value of benefits and perquisites. Income denotes periodical monetary return with some sort of regularity from definite source. The act does not define income. It simply lists some of the items that can be included in the income. Thus;

Income includes:

1. Profits and gains
2. Dividend
3. Voluntary Contributions received by a trust. Voluntary contributions received by a trust are included in the definition of income. As such contributions received by following types of trusts, funds, associations, bodies etc. are included in the income of such bodies.
  - i. Contributions received by a trust created wholly or partly for charitable or religious purposes.
  - ii. Contributions received by a scientific research association.
  - iii. Contributions received by a fund or institution set up for charitable purposes and notified u/s 10(23c)(iv)(v).
  - iv. Contribution received by any university or other educational institution, hospital referred in section 10(23c).
4. The value of any perquisite or profit in lieu of salary taxable under section 17(2)(3)
5. Any special allowance or benefit, other than perquisite included under sub-clause (iii), specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit
6. Any allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living
7. Value of any benefit or amenity, whether convertible into money or not, obtained by a representative assessee or by any person on whose behalf such benefit is received by representative assessee and sum paid by representative assessee in respect of any obligation which but for such payment would have been payable by the person on whose behalf representative assessee has made such payments
  - A. The profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members;

The value of any benefits or perquisites, whether convertible into money or not, obtained from a company either by a director or by a person, who has a substantial interest in the company, or by a relative of a director of such person, and any sum paid by such company in respect of any

obligation but for which, such payment would have been payable by the director or other person aforesaid.

Any sum chargeable to income-tax under section 28(u) and (iii) or section 41 or section 59;

Any sum chargeable to tax u/s 28 (iiia)

Any sum chargeable to tax u/s 28(iiib)

Any sum chargeable to tax u/s 28 (iiic) , -

The value of any benefit or perquisite taxable under section 28 (iv)

Any capital gain taxable under section 45

Any sum whether received or receivable in cash or in kind under an agreement for—not carrying out any activity in relation to any business ; or not sharing any know-how, patent, copyright, trade-mark, license, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision of services

The profit and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society, computed in accordance with section 44 or any surplus taken to be such profits and gains by virtue of provisions contained in the first schedule

Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever

Any sum received by the assessee as his employers' contributions to any provident fund or superannuation fund or any fund set up under the provisions of the Employee's State Insurance Act, 1948 or any other fund for the welfare of such employees

Any sum received under a key man insurance policy including the sum allocated by way of bonus on such policy

Any sum received by an individual or HUF from any person during 2013-14 in cash or by issue of cheque or draft or by any other mode or by way of credit otherwise than by way of consideration for goods or services but does not include

An aggregate amount of gift or gifts received (whether in cash or in the form of property) exceeding Rs. 50,000 in a previous year by an individual or Hindu undivided family from non-relatives shall be treated as income which will be taxable in the hands of the recipient. (For details, please refer to chapter on Other Sources)

Gifts received by a firm or closely held company as provided in Section 56(2)(viiia).

Any consideration for issue of shares by a closely held company as exceeds the fair market value of shares as provided in Section 56(2)(viib) [w.e.f. Assessment year 2013-14].

0. The definition of term 'Income' as given above does not explain what income is ? It only tells that the above mentioned receipts are also included in the meaning of term income. The definition given u/s 2(24) is inclusive and not exhaustive. According to



English dictionary, the term income means “periodical receipts from one ‘s business, land, work, investments etc.”

1. The term income simply means something which comes in. It is a periodical return with regularity or expected regularity. It’s nowhere mentioned that income refers to only monetary return. It includes value of benefits and perquisites. Any thing which can reasonably and properly be described as income is taxable under this Act unless specifically exempted under the various provisions of this Act.
2. The term income includes not only what is received by using the property but also the amount saved by using it himself. Any thing which is convertible into income can be regarded as source of accrual of income.

### **PERSON [SEC. 2 (31)]**

#### **The term person includes the following:**

- (i) an Individual;
- (ii) a Hindu Undivided Family (HUF);
- (iii) a Company;
- (iv) a Firm;
- (v) an Association of Persons (AOP) or a Body of Individuals (BOI), whether incorporated or not;
- (vi) a Local authority; &
- (vii) every artificial juridical person not falling within any of the preceding categories.

### **PREVIOUS YEAR [SEC.3]**

Previous Year means the financial year immediately preceding the Assessment Year. Income earned in a year is assessed in the next year. The year in which income is earned is known as Previous Year and the next year in which income is assessed is known as Assessment Year. It is mandatory for all assessee to follow financial year (from 1st April to 31st March) as previous year for Income-Tax purpose.

#### **Financial Year**

According to sec. 2(21) of the General Clauses Act, 1897, a Financial Year means the year commencing on the 1st day of April. Hence, it is a period of 12 months starting from 1st April and ending on 31st March of the next year. It plays a dual role i.e. Assessment Year as well as Previous Year.

Example: Financial year 2018-19 is -

- Assessment year for the Previous Year 2017-18; and
- Previous Year for the Assessment Year 2019-20.

## Gross Total Income Sec: 80b (5)

As per section 14, the income of a person is computed under the following five heads:

1. Salaries.
2. Income from house property.
3. Profits and gains of business or profession.
4. Capital gains.
5. Income from other sources.

If the income is not derived from any of the above sources, it is not taxable under the act. The aggregate income under these heads is termed as “gross total income”.

## Total Income Sec : 2(45)

Total income means the amount left after making the deductions under section 80C to 80U from the gross total income.

## Casual Income

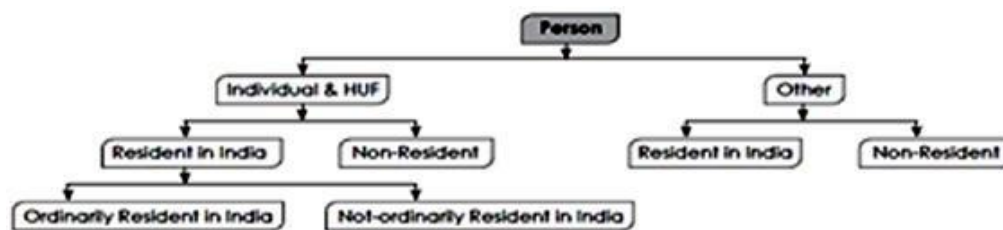
Any receipt which is of a casual and non-recurring nature is called casual income. Casual income includes the following receipts:

1. Winning from lotteries,
2. Winning from crossword puzzles,
3. Winning from races (including horse races),
4. Winning from card games and other games of any sort
5. Winning from gambling or betting of any form or nature.

## RESIDENTIAL STATUS

Residential status of an assessee determines the scope of chargeability of his income. Whether a person will be charged to a particular income or not, depends on his residential status.

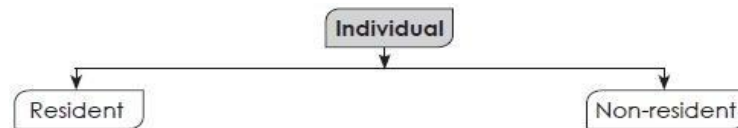
Sec. 6 provides the test for residential status for the persons which can be categorized as under:



## DETERMINATION OF RESIDENTIAL STATUS

### INDIVIDUAL [SEC. 6(1)]

First of all, an individual is classified as resident or non-resident and again a resident individual may further be categorized as Ordinarily Resident or Not Ordinarily Resident in India.



#### ***Resident in India***

An individual is said to be a resident in India, if he satisfies any one of the following conditions -

- i) He is in India in the previous year for a period of 182 days or more [Sec. 6(1)(a)]; or
- ii) He is in India for a period of 60 days or more during the previous year and for 365 or more days during 4 previous years immediately preceding the relevant previous year [Sec. 6(1)(c)]

**Tax point:** Given Conditions are alternative in nature i.e. assessee needs to satisfy any one condition.

#### ***Non-Resident in India***

An assessee who is not satisfying sec. 6(1) shall be treated as a non-resident in India for the relevant previous year.

### ***ILLUSTRATION***

Sam came to India first time during the P.Y. 2018-19. During the previous year, he stayed in India for (i) 50 days; (ii) 183 days; & (iii) 153 days. Determine his residential status for the A.Y. 2019-20.

#### **Solution**

- (i) Since Sam resides in India only for 50 days during the P.Y. 2018-19, he does not satisfy any of the conditions specified in sec. 6(1). He is, therefore, a non-resident in India for the P.Y. 2018-19.
- (ii) Since Sam resides in India for 183 days during the previous year 2018-19, he satisfies one of the conditions specified in sec. 6(1). He is, therefore, a resident in India for the P.Y. 2018-19.
- (iii) Sam resides in India only for 153 days during the previous year 2018-19. Though he resided for more than 60 days during the previous year but in 4 years immediately preceding the previous year (as he came India first time), he did not reside in India. Hence, he does not satisfy any of the conditions specified in sec. 6(1). Thus, he is a non-resident for the P.Y. 2018-19.

### **ILLUSTRATION**

Andy, a British national, comes to India for the first time during 2014-15. During the financial years 2014-15, 2015-16, 2016-17, 2017-18 and 2018-19, he was in India for 55 days, 60 days, 80 days, 160 days and 70 days respectively. Determine his residential status for the assessment year 2019-20.

### **Solution**

During the previous year 2018-19, Andy was in India for 70 days & during 4 years immediately preceding the previous year, he was in India for 355 days as shown below:

Year	2014-15	2015-16	2016-17	2017-18	Total
No of days stayed in india	55	60	80	160	355

### **ILLUSTRATION**

Miss Pal, an Indian citizen, left India for first time on 1st April, 2018 for joining job in Tokyo. She came to India on 11th October, 2018 for only 190 days. Determine her residential status for P.Y. 2018-19.

### **Solution**

Number of days Miss Pal stayed in India can be calculated as under:

P.Y.	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Total
18-19	1	-	-	-	-	-	21	30	31	31	28	31	173
19-20	18	-	-	-	-	-	-	-	-	-	-	-	18

Since she left India for employment purpose, hence for becoming resident she has to stay in India for at least 182 days. However, she is in India for only 173 days during the previous year, thus she is a non-resident for the P.Y. 2018-19.

### **Resident and ordinarily resident**

If a resident individual satisfies the following two additional conditions, he will be treated as resident & ordinarily resident in India -

- He has been resident in India [as per sec. 6(1)] in at least 2 out of 10 previous years immediately preceding the relevant previous year and
- He has resided in India for a period of 730 days or more during 7 previous years immediately preceding the relevant previous year.

**Tax point:** To be a Resident & Ordinarily resident in India, one has to satisfy at least one condition of sec. 6(1) & both the additional conditions of sec. 6(6).

### Resident but not ordinarily resident

If a resident individual does not satisfy both additional conditions as given u/s 6(6), he is “Resident but not ordinarily resident in India”.

### ILLUSTRATION

Mr. X, aged 19 years, left India for first time on May 31, 2018. Determine his residential status for the previous year 2018-19 if:

- i) He left India for employment purpose ii) He left India on world tour.

### Solution

During the previous year 2018-19, Mr. X was in India for 61 days as shown below –

P.Y.	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Total
18-19	30	31	-	-	-	-	-	-	-	-	-	-	61

### ILLUSTRATION

X came India for first time on July 24, 2014. From July 24, 2014 to December 25, 2015 he was in India. Again, he came to India on August 5, 2018 for employment purpose & left India on November 25, 2018 permanently. Determine his residential status for the previous year 2018-19 assuming -

- a) He is a foreign citizen

- b) He is an Indian citizen

### Solution

During the previous year 2018-19, X was in India for 113 days as shown below:

Year	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Total
18-19	-	-	-	-	27	30	31	25	-	-	-	-	113

Further, he was in India for more than 365 days during 4 years immediately preceding the previous year as shown below

Year	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Total
14-15	-	-	-	8	31	30	31	30	31	31	28	31	251
15-16	30	31	30	31	31	30	31	30	25	-	-	-	269
16-17	-	-	-	-	-	-	-	-	-	-	-	-	-
17-18	-	-	-	-	-	-	-	-	-	-	-	-	-

As he satisfies condition given in sec. 6(1)(c), he is a resident in India.

Further, he was resident during 2 out of 10 years immediately preceding the relevant previous year but he was in India only for 520 days in 7 years immediately preceding the relevant previous year. As he is not satisfying dual conditions of sec. 6(6), he is a resident but not ordinarily resident in India for the previous year 2018-19.

**Note:** His status shall remain same in both the cases as -

- a) Foreign citizens are not covered by 'exceptions to sec. 6(1)(c)'.
- b) Coming in India for employment purpose is not covered by 'exceptions to sec. 6(1)(c)'.

### **ILLUSTRATION**

X, a foreign citizen, resides in India during the previous year 2018-19 for 83 days. Determine his residential status for previous year 2018-19 assuming his stay in India during the last few previous years are as follows –

Year	Days	Year	Days	Year	Days	Year	Days
2003-04	220 days	2007-08	36 days	2011-12	137 days	2015-16	175 days
2004-05	15 days	2008-09	115 days	2012-13	265 days	2016-17	15 days
2005-06	257 days	2009-10	123 days	2013-14	310 days	2017-18	67 days
2006-07	110 days	2010-11	65 days	2014-15	121 days		

### **Solution**

During previous year 2018-19, X was in India for 83 days & during 4 years immediately preceding the previous year, he was in India for 378 days as shown below:

Year	2014-15	2015-16	2016-17	2017-18	Total
No. of days stayed in India	121	175	15	67	378

Thus, he satisfies one of the conditions specified u/s 6(1) & consequently, he becomes resident in India in the P.Y. 2018- 19. Further, to determine whether X is an ordinarily resident or not, he needs to satisfy both conditions laid down u/s 6(6).

Year	Presence in India (In Days)	Resident or Non resident	Condition satisfied to become a resident
2017-2018	67	Resident	6(1)(c)
2016-2017	15	Non Resident	None
2015-2016	175	Resident	6(1)(c)
2014-2015	121	Resident	6(1)(c)
2013-2014	310	Resident	Both
2012-2013	265	Resident	Both
2011-2012	137	Non Resident	None
2010-2011	65	Resident	6(1)(c)
2009-2010	123	Resident	6(1)(c)
2008-2009	115	Resident	6(1)(c)

Condition (i) of sec. 6(6) requires that an individual should be resident in India for at least 2 out of 10 years preceding the relevant previous year. X was resident in India for 8 out of 10 years immediately preceding the previous year. Thus, he satisfies this condition.

Condition (ii) of sec. 6(6) requires that an individual should be present in India for at least 730 days during 7 years preceding to relevant previous year. X was in India for 1090 days during 2011-12 to 2017-18. Hence, he satisfies this condition also.

X satisfies condition (ii) of sec. 6(1) as well as both the conditions of sec. 6(6). Thus, he is a resident and ordinarily resident in India for the previous year 2018-19.

### **HINDU UNDIVIDED FAMILY (HUF) [SEC. 6(2)]**

An HUF can be either a resident or non-resident in India. Again, a resident HUF can further be classified as 'Ordinarily resident' and 'Not ordinarily resident'.

**Resident HUF:** When the control & management<sup>1</sup> of affairs of HUF is wholly or partly situated in India during the relevant previous year, then it is treated as resident in India.

<sup>1</sup> *Control & management* means -

- controlling & directive power;
- actual control & management (mere right to control & manage is not enough);
- central control & management and not the carrying out of day to day affairs.

The place of central control & management is situated where the head, the seat & the directing power is situated.

**Non-resident HUF:** An HUF is non-resident in India if the control & management<sup>1</sup> of its affairs is wholly situated outside India.

**Ordinarily resident in India:** If the '*karta*' or manager of a resident HUF satisfies both additional conditions given u/s 6(6), HUF is said to be an ordinarily resident. If the '*karta*' or manager of a resident HUF do not satisfies both additional conditions given u/s 6(6), HUF is said to be a not-ordinarily resident.

## **COMPANY [SEC. 6(3)]**

**Resident Company:** An Indian company is always a resident in India.

A non-Indian company is said to be a resident in India, if its place of effective management, in that year, is in India.

“Place of effective management” means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole, are in substance made.’

**Non-Resident Company:** If place of effective management, in that year, is not in India, the said company is non-resident in India for the relevant previous year.

Tax point: In case of company, there is no sub-division like ‘Ordinarily resident’ or ‘Not ordinarily resident’.

## **FIRM OR AN ASSOCIATION OF PERSONS (AOP) OR BODY OF INDIVIDUALS (BOI) [SEC. 6(4)]**

**Resident:** A firm or an AOP or BOI is said to be a resident in India, if control & management of its affairs are wholly or partly situated in India during the relevant previous year.

Control & management is vested in hands of partners in case of firm and principal officer in case of an AOP/BOI.

**Non-resident:** If control & management of its affairs are situated wholly outside India, then it is a non-resident in India.

Tax point: In case of firm or BOI or AOP, there is no subdivision like ‘Ordinarily resident’ or ‘Not ordinarily resident’.



## INCIDENCE OF TAX [SEC. 5]

The following chart highlights the provisions of tax incidence in brief:

Nature of Income	Tax incidence in case of		
	Resident & ordinarily resident	Resident but not ordinarily resident	Non resident
Income accrued or deemed to be accrued and received or deemed to be received in India	Taxable	Taxable	Taxable
Income accrued outside India but received or deemed to be received in India.	Taxable	Taxable	Taxable
Income accrued or deemed to be accrued in India but received outside India	Taxable	Taxable	Taxable
Income accrued and received outside India from a business controlled in or profession set-up in India.	Taxable	Taxable	Not taxable
Income accrued and received outside India from a business controlled or profession set-up outside India.	Taxable	Not taxable	Not taxable
Income accrued and received outside India in the previous year (it makes no difference if the same is later remitted to India).	Taxable	Not taxable	Not taxable
Income accrued and received outside India in any year preceding the previous year and later on remitted to India in current financial year.	Not taxable	Not taxable	Not taxable
Note: In case of resident assessee like company, firm etc. (Other than Individual and HUF) in which there is no classification as 'Resident but not ordinarily resident', income accrued and received outside India from a business controlled or profession setup outside India shall be taxable.			

## ILLUSTRATION

Ram provides following details of income, calculate the income which is liable to be taxed in India for the A.Y.2019-20 assuming that –

(a) He is an ordinarily resident (b) He is not an ordinarily resident (c) He is a non-resident.

Particulars	Amount (₹)
Salary received in India from a former employer of UK	1,40,000
Income from tea business in Nepal being controlled from India	10,000
Interest on company deposit in Canada (1/3rd received in India)	30,000
Profit from a business in Mumbai controlled from UK	1,00,000
Profit for the year 2002-03 from a business in Tokyo remitted to India	2,00,000
Income from a property in India but received in USA	45,000
Income from a property in London but received in Delhi	1,50,000
Income from a property in London but received in Canada	2,50,000
Income from a business in Jambia but controlled from Turkey	10,000

## Solution

Calculation of income liable to be taxed in India of Ram for the A.Y.2019-20

Particulars	Resident & Ordinarily resident	Resident but not ordinarily resident	Non-resident
Salary received in India from a former employer of UK	1,40,000	1,40,000	1,40,000
Income from tea business in Nepal being controlled from India	10,000	10,000	Nil
<u>Interest on company deposit in Canada</u>			
-	10,000	10,000	10,000
- 1/3rd received in India			
- 2/3rd received outside India	20,000	Nil	Nil
Profit from a business in Mumbai controlled from UK	1,00,000	1,00,000	1,00,000
Past Profit from a business in Tokyo remitted to India	Nil	Nil	Nil
Income from a property in India but received in USA	45,000	45,000	45,000
Income from a property in London but received in Delhi	1,50,000	1,50,000	1,50,000
Income from a property in London but received in Canada	2,50,000	Nil	Nil
Income from a business in Jambia but controlled from Turkey	10,000	Nil	Nil
<b>Income liable to tax in India</b>	<b>7,35,000</b>	<b>4,55,000</b>	<b>4,45,000</b>

## KINDS OF INCOME

### 1. Income received in india

Income received in India is taxable in all cases (whether accrued in India or elsewhere) irrespective of residential status of the assessee, therefore it is significant to know the meaning of income received in India. If the place, where the recipient gets the money (on first occasion) under his control, is in India, it is said to be income received in India.

### 2. INCOME DEEMED TO BE RECEIVED IN INDIA

Following incomes shall be deemed to be received in India and taxable in hands of all assessee irrespective of their residential status -

- a) The annual accretion in the previous year to the balance at the credit of an employee participating in a recognized provident fund, to the extent provided in Rule 6 of part A of the IV schedule i.e.-

- i) Employer's contribution to the recognized provident fund in excess of 12% of salary.
- ii) Interest credited on the above balance by a rate exceeding 9.5% [Sec. 7(i)]
- b) The transferred balance in recognized provident fund, to the extent liable to income tax [Sec. 7(ii)]
- c) The contribution made, by the employer in the previous year, to the account of an employee under a pension scheme notified u/s 80CCD [Sec. 7(iii)]
- d) Tax Deducted at source [Sec. 198]
- e) Deemed profit.
- f) Income from undisclosed sources

3. income which accrues or arises in india

Income is said to accrue or arise of an assessee only when he obtains a rights to receive it. Accrual simply means the amount earned. No amount can be said to accrue unless it is actually due.

4. Income deemed to accrue or arise in India [sec. 9]

Following incomes are deemed to accrue or arise in India:

Income from connection in India	Salary earned in India	Salary from Govt. by an Indian citizen for services rendered outside India	Income from dividend paid by an Indian company	Income from interest payable by specified person	Income from royalty	Income from technical services
Sec. 9(1)(i)	Sec. 9(1)(ii)	Sec. 9(1)(iii)	Sec. 9(1)(iv)	Sec. 9(1)(v)	Sec. 9(1)(vi)	Sec. 9(1)(vii)

### GENERAL ILLUSTRATION

#### **ILLUSTRATION**

Miss Monica, a foreign national, comes India every year for 90 days since 2003-04.

- a) Determine her residential status for the previous year 2018-19.
- b) Will your answer differ, if she comes India for 100 days instead of 90 days every year.

#### **Solution**

- a) Since Miss Monica stayed for 90 days during the previous year 2018-19 and for 360 days (90 days × 4 years) during the 4 years immediately preceding the previous year, hence, she is not satisfying any of the conditions of sec. 6(1). Thus, she is a non-resident for the previous year 2018-19.

b) Since Miss Monica stayed for 100 days during the previous year 2018-19 and for 400 days (100 days × 4 years) during the 4 years immediately preceding the previous year, hence, she is satisfying sec. 6(1)(c). Thus, she is resident for the previous year 2018-19. Further, she resides for only 700 days (100 days × 7 years) during the 7 years immediately preceding the previous year. Hence, she does not satisfy one of the conditions of sec. 6(6). Thus, she is resident but not ordinarily resident for the previous year 2018-19.

### **ILLUSTRATION**

Mr. Sid, a British national, joined XYZ Co. Ltd. as an engineer in India on 1st May, 2008. On 31st December, 2009, he went to Sri Lanka on deputation. On 1st April, 2014, he came back to India and left for Sri Lanka again on 31st May, 2014. He returned to India and joined his original post on 1st July, 2018. Determine his residential status for the A.Y. 2019-20.

### **Solution**

Number of days Mr. Sid stayed in India in past few years can be calculated as under:

SN	P.Y.	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Total
0	18-19	-	-	-	31	31	30	31	30	31	31	28	31	274
1	17-18	-	-	-	-	-	-	-	-	-	-	-	-	0
2	16-17	-	-	-	-	-	-	-	-	-	-	-	-	0
3	15-16	-	-	-	-	-	-	-	-	-	-	-	-	0
4	14-15	30	31	-	-	-	-	-	-	-	-	-	-	61
5	13-14	-	-	-	-	-	-	-	-	-	-	-	-	0
6	12-13	-	-	-	-	-	-	-	-	-	-	-	-	0
7	11-12	-	-	-	-	-	-	-	-	-	-	-	-	0
8	10-11	-	-	-	-	-	-	-	-	-	-	-	-	0
9	09-10	30	31	30	31	31	30	31	30	31	-	-	-	275
10	08-09	-	31	30	31	31	30	31	30	31	31	28	31	335

On the basis of data drawn, residential status of Mr. Sid in last few years can be decided as under:

Year	Previous Year	Presence in India (In days)	Resident (R) or Non resident (NR)	Condition satisfied to become a resident
1	2017-2018	0	NR	None
2	2016-2017	0	NR	None
3	2015-2016	0	NR	None
4	2014-2015	61	NR	None
5	2013-2014	0	NR	None
6	2012-2013	0	NR	None
7	2011-2012	0 = 61	NR	None
8	2010-2011	0	NR	None
9	2009-2010	275	R	6(1)(a)
10	2008-2009	335	R	6(1)(a)

Since assessee resided in India for 274 days in the previous year 2018-19, hence he satisfies sec. 6(1)(a). Therefore, he is resident in India.

Further, since he is resident in India for 2 years out of 10 years preceding the previous year (as shown in above working), but resided in India for less than 730 days out of 7 immediately preceding years, hence he does not satisfy one of the conditions of sec. 6(6), therefore, he is resident but not ordinarily resident.

Conclusion: Resident but not ordinarily resident.

### Illustration

State how the following incomes are to be assessed in the hands of an assessee who is

- a. Resident
  - b. Non-resident and
  - c. Non resident
1. Salary received during the year for employment outside india from government of india Rs. 50000.
  2. Profits earned in UK and received in India rs. 35000
  3. Salary drawn for employment in Singapore office of an indian company for two months Rs. 7500
  4. Dividend received from an Indian company Rs. 8000
  5. Profit earned from business transaction outside india and kept in Punjab national bank rs.25000

## Solution

### Computation of total income

Particulars of income	Resident	Not ordinarily resident	Non resident
Income accruing or arising in india. But received outside india	50000	50000	50000
Profit earned in UK and received in india	35000	35000	35000
Salary drawn for employment in Singapore from an Indian company	7500	Nil	Nil
Profit earned from business transaction outside india and kept in Punjab national bank	25000	Nil	Nil
	117500	85000	85000

Note: dividend from a domestic company is exempt in all cases.

## Illustration

From the following particulars submitted by mis rabeeha as regards her income in the previous year 2018-19 compute her gross total income if she is

- a. Resident and ordinary resident
  - b. Resident but not ordinary resident and
  - c. Non resident
1. Income from agriculture in srilanka received in Srilanka and remitted to india.Rs. 25000
  2. Pension from an Indian employer received abroad Rs. 12000
  3. Past untaxed profits brought to india Rs. 50000
  4. Rental income from the property in Nepal received outside india Rs. 17000
  5. Annual value of a single self occupied property in india Rs. 3600

## Solution

Computation of gross total income of Miss Rabeeha

Particulars of income	Resident	Not ordinarily resident	Non resident
Salary	12000	12000	12000
House property let out In Nepal 17000 Less 30% 5100	11900	nil	nil
Agriculture income in Srilanka	25000	Nil	Nil
Past un expected income	nil	Nil	Nil
Total income	48900	12000	12000

## Illustration

Mr. Vineethan has the following incomes during the assessment year 2019-20. Compute his total income for the assessment year 2019-20 if he is resident of India, not ordinarily resident of India and non-resident of India.

1. Capital gain on sale of a house in Mumbai Rs. 40000
2. Salary received outside India for rendering service in India Rs. 50000
3. Interest received from government of India (received outside India) Rs. 15000
4. Technical fees received from an India company (received in India for advice given in respect of project outside India) Rs. 80000
5. Income from a business situated outside India (controlled wholly outside India) Rs. 25000

## Solution

Particulars of income	Resident	Not ordinarily resident	Non resident
Capital gain on sale of a house	40000	40000	40000
Salary received outside India for rendering service in India	50000	50000	50000
Interest received from government of India	15000	15000	15000
Technical fees received from an India company	80000	80000	
Income from a business situated outside India	25000		
Income from business connection in India	35000	35000	35000
	245000	220000	140000

# AGRICULTURE INCOME

The income tax does not define the term agriculture income. Instead it gives a list income that can be treated as agricultural income. Section 2(1A) of the Act defines agricultural income as follows :

1. Any rent or revenue derived from land that is situated in india and is used for agricultural purpose;
2. Any income derived from such land by-
  - a. Agriculture ; or
  - b. Any process ordinarily employed by a cultivator or receiver of rent-in-kind to make the produce fit to be taken to market or
  - c. The sale by a cultivator or receiver of rent in kind of the produce in respect of which no process has been performed other than a process of the nature described in the above paragraph.
3. Any income derived from farmhouse.

## Criteria to determine agricultural income

1. Income received from land situated in India.
2. Land is used for agricultural purpose.
3. Land is situated in india

By virtue of sec. 2(1A), agricultural income means –

1. Any rent or revenue derived from a land, which is situated in India & is used for agricultural purposes\$;
2. Any income derived from such land by agriculture\$
3. Any income derived from such land by the performance by –
  - a) a cultivator;
  - b) receiver of rent in kind;- of any process ordinarily employed by a them to render the produce raised or received by him fit to be taken to market.
4. Any income derived from such land by the sale by
  - a) a cultivator of the produce raised by him; or
  - b) receiver of rent-in-kind of the produce received by him;



- in respect of which no process has been performed other than a process required to render it fit for the market.

5. Any income derived from a building subject to fulfillment of the following conditions -

- a) The building should be occupied by the cultivator or receiver of rent in kind.
- b) The building should be on or in the immediate vicinity of the land, being situated in India and used for agricultural purposes.
- c) The building should be used as dwelling house or store-house or other out building.
- d) The land is either situated in –
  - i) Rural area; or
  - ii) Urban area<sup>1</sup> and assessed to land revenue / local rates.

### **Partly agriculture income**

Partly agricultural income consists of both the element of agriculture and business, so non agricultural part of the income is taxed. Some examples for partly agricultural income are given below:

#### **1. Profit of business other than Tea**

This rule applicable to agricultural produce like cotton, tobacco, and sugarcane etc, here the market value of the agricultural produce raised by the Assessee for utilizing it as raw material for his business will be deducted out of the total profit of such Assessee while calculating tax on his income.

#### **2. Profit from Tea manufacturing**

If a person using his own tealeaves grown by him for his tea manufacturing business, then 60% of his income will be treated as agricultural income and the remaining 40 % will be treated as business income. So he has to pay tax on that remaining 40% of income.

#### **3. Income from the manufacturing of centrifuged latex or cenex**

If a person manufacturing centrifuged latex by using his own made raw then, 65 % of the income derived from the sale of the same is treated as agricultural income so he has to pay tax remaining part of the income.

#### **4. Income from the coffee manufacturing**

a) 75% of the income derived from the sale of coffee grown and cured by the seller in India is deemed to be agricultural income 25% is taken as business income.

b) 5% the income derived from the sale of coffee grown, cured, roasted and grounded by the seller in India is deemed to be agricultural income 40% is taken as business income.

### **Illustration:1**

Mr. Ramsanth had estates in Rubber, tea and coffee. He derives income from them. He furnishes the following particulars of his income for the year ending 31-3-2013.

Manufacture of rubber Rs: 5,00,000

Manufacture of coffee grown and cured Rs: 3,50,000

Manufacture of tea Rs: 7,00,000

Compute taxable income of Ramsanth for the A. Y. 2013-14.

### **Solution :**

#### **Computation of Taxable income for the A.Y.2013-14:**

Manufacture of rubber ( 35% is non-agricultural income) :	175,000
Manufacturing of Coffee (25% is non-agricultural income) :	87,500
Manufacturing of tea ( 40% is non-agricultural income) :	2,80,000
Taxable Income	: 5,42,500

### **Assessment of agricultural income**

Agricultural income is totally exempt from income tax. However, the agricultural income is integrated with non agricultural income in certain cases of assessees. The integration is done where assessee has both agricultural and non agricultural income. For the assessment of agricultural income both agricultural and non agricultural income of an assessee is determined as per the various rules prescribed by the income tax Act.

#### **COMPUTATION OF AGRICULTURAL INCOME**

Agricultural income of an assessee can be computed as per the rules given below.

1. Rent or revenue derived from agricultural land will be computed on the same basis as is adopted for the computation of income under the head **income from other sources**
2. Income derived from agricultural house property is computed as if it were income chargeable to income tax under the head **income from house property**
3. Income derived from agricultural operations is computed as if it were income chargeable to income tax under the head profit or gains from business or profession.
4. Loss incurred in agriculture will be allowed to be set off only against gains from agriculture.
5. Any sum payable to the government in the form of tax charged by the state government on agriculture will be allowed as a deduction.

#### **Method of integration**

1. Net agricultural income is integrated with non agricultural income.
2. Income tax is calculated on this integrated income at the rates prevailing each assessment year.

3. Then income tax will be calculated on the net agricultural income as increased by an amount of Rs. 250000 or 300000 or Rs. 500000 as the case may be.
4. Income tax calculated under 3 above is deducted from the income tax calculated 2 above

## Casual Income

Any receipt which is of a casual and non-recurring nature is called casual income. Casual income.

includes the following receipts:

1. Winning from lotteries,
2. Winning from crossword puzzles,
3. Winning from races (including horse races),
4. Winning from card games and other games of any sort
5. Winning from gambling or betting of any form or nature.

## Capital and revenue receipts and expenditure

Receipts which are non-recurring (not received again and again) by nature and whose benefit is enjoyed over a long period are called "Capital Receipts", e.g. money brought into the business by the owner (capital invested), loan from bank, sale proceeds of fixed assets etc. Capital receipt is shown on the liabilities side of the Balance Sheet. receipts which are recurring (received again and again) by nature and which are available for meeting all day to day expenses (revenue expenditure) of a business concern are known as "Revenue receipts", e.g. sale proceeds of goods, interest received, commission received, rent received, dividend received etc.

### Distinction between Capital Receipt and Revenue Receipt:

No.	Revenue receipt	Capital receipt
1	It has short-term effect. The benefit is enjoyed within one accounting period.	It has long-term effect. The benefit is enjoyed for many years in future.
2	It occurs repeatedly. It is recurring and Regular in nature.	It does not occur again and again. It is Non recurring and irregular in nature.
3	It is shown in profit and loss account on the credit side.	It is shown in the Balance Sheet on the liability side.
4	It does not produce capital receipt.	Capital receipt, when invested, produces revenue receipt e.g. when capital is invested by the owner, business gets revenue receipt (i.e. sale proceeds of goods etc.).
5	This does not increase or decrease the value of asset or liability.	The capital receipt decreases the value of asset or increases the value of liability e.g. sale of a fixed asset, loan from bank etc.
6	Sometimes, expenses of capital nature are to be incurred for revenue receipt, e.g. purchase of shares of a company is capital expenditure but dividend received on shares is a revenue receipt.	Sometimes expenses of revenue nature are to be incurred for such receipt e.g. on obtaining loan (a capital receipt) interest is paid until its repayment.

### Difference between Capital Expenditure and Revenue Expenditure:

No.	Revenue expenditure	Capital expenditure
1	Its effect is temporary, i.e. the benefit is received within the accounting year.	Its effect is long-term, i.e. it is not exhausted within the current accounting year-its benefit is received for a number of years in future.
2	Neither an asset is acquired nor is the value of an asset increased.	An asset is acquired or the value of an existing asset is increased.
3	It has no physical existence because it is incurred on items which are used by the business.	Generally it has physical existence except intangible assets.
4	It is recurring and regular and it occurs repeatedly.	It does not occur again and again. It is Non recurring and irregular.
5	This expenditure helps to maintain the business.	This expenditure improves the position of the business.
6	The whole amount of this expenditure is shown in trading P & L A/c or income statement.	A portion of this expenditure (depreciation on assets) is shown in trading & P & L A/c and the balance are shown in the balance sheet on asset side.
7	It does not appear in the balance sheet.	It appears in the balance sheet until its benefit is fully exhausted.
8	It reduces revenue (profit) of the business	It does not reduce the revenue of the concern.

### Illustration

Compute tax liability of Mr. Gulam for the assessment year 2019-20

Total income Rs. 400000      Agriculture income Rs. 3000

#### Solution

Agriculture income		400000
Agriculture income (less than Rs. 5000)		<u>nil</u>
Total income		400000
Computation of income tax		
First	rs. 250000	nil
Next	Rs. 150000 @ 5%	<u>7500</u>
Income tax payable		7500
Less tax rebate	<u>nil</u>	
		7500
Add education and health	cess 4%	<u>300</u>
Total amount payable		7800

## Illustration

Calculate the tax liability of HUF whose computed total income is Rs. 280000 and net agricultural income is rs. 7000 for the assessment year 2019-20.

Total income	280000
Agricultural income	7000
<b>Total integrated income</b>	<b>287000</b>

Income tax on 3 above (note 1)	1850
Less income tax on agriculture income increased by taxable limit Rs. 250000+7000(note 2)	350
<b>Total tax liability</b>	<b>1500</b>
Less tax rebate	1500
	nil

Note:1

First Rs. 250000		nil
Next Rs. 37000	@5%	<u>1850</u>
		1850
Note 2 Calculation of income tax on		257000
First Rs. 250000		nil
Next Rs. 7000	@5%	<u>350</u>
		350

## EXEMPTED INCOME

### INCOME WHICH DON'T FORM PART OF TOTAL INCOME

Sec. 10 enlists the various income which are exempt from tax i.e. does not form part of total income of the assessee. These are –

#### **Agricultural Income [Sec. 10(1)]**

Fully exempted

#### **Member's Share in Income of HUF [Sec. 10(2)]**

Any sum received by an individual as a member of a Hindu undivided family –

- Where such sum has been received out of the income of the family; or
- Where such sum has been received out of the income of an impartible estate belonging to the family.

### **Share of Profit from a Firm [Sec. 10(2A)]**

Share in the total income of the firm is exempt in the hands of partner.

### **Interest Income of Non-resident [Sec. 10(4)/(4B)]**

- Interest on specified securities or bonds, including premium on redemption of such bonds is exempted in the hands of a non-resident [Sec. 10(4)(i)]
- Interest on Non-Resident (External) Account in any bank in India to a person who is a resident outside India as per as defined in sec. 2(w) of the Foreign Exchange Management Act, 1999 or is a person who has been permitted by the Reserve Bank of India to maintain the aforesaid Account
- Interest on notified savings certificates issued before 1-6-2002 by the Central Government to a non-resident, being a citizen of India or a person of Indian origin [Sec. 10(4B)]

### **Leave Travel Concession [Sec. 10(5)]**

Refer chapter Salaries.

### **Remuneration to Person who is not a Citizen of India in certain cases [Sec. 10(6)]**

Following remuneration to an individual who is not a citizen of India shall be exempt –

- Remuneration received by him as an official of an embassy, high commission, legation, commission, consulate, or the trade representation of a foreign state or as a staff of any of these officials provided corresponding Indian officials in that foreign country enjoy similar exemptions in their country - Sec. 10(6)(ii).
- Remuneration received as an employee of a foreign enterprise for services rendered by him during his stay in India provided -
  - a. the foreign enterprise is not engaged in any business or profession in India;
  - b. his stay in India does not exceed 90 days in aggregate; and
  - c. such remuneration is not liable to be deducted from the income of the employer under this Act - Sec. 10(6)(vi)
- Remuneration for services rendered in connection with his employment on a foreign ship provided his total stay in India does not exceed 90 days in the previous year - Sec. 10(6)(viii)
- Remuneration received as an employee of the Government of a foreign State during his stay in India in connection with his training in any undertaking owned by Government, Government company, subsidiary of a Government company, corporation established by any Central, State or Provincial Act and any society wholly financed by the Central or State Government – Sec. 10(6)(xi)

**Tax paid by Government on Royalty or Fees for Technical Service [Sec. 10(6A)]**

**Tax paid by Government on Income of a Non-resident or a Foreign Company [Sec. 10(6B)]**

**Tax paid on Income from Leasing of Aircraft [Sec. 10(6BB)]**

Tax paid by an Indian company on income arising from leasing of aircraft, etc. to the Government of a foreign state or foreign enterprise under an approved agreement entered into with such Indian company engaged in the business of operation of aircraft, provided such agreement was entered into between 1-4-1997 and 31-3-1999 or after 31-3-2007.

**Fees for Technical Services in Project connected with Security of India [Sec. 10(6C)]**

Any income arising to notified foreign company by way of royalty or fees for technical services received in pursuance of an agreement entered into with Central Government for providing services in or outside India in projects connected with security of India.

**Income from service provided to National Technical Research Organization [Sec. 10(6D)]**

Any income arising to a non-resident or to a foreign company, by way of royalty from, or fees for technical services rendered in or outside India to, the National Technical Research Organization.

**Allowance or Perquisite paid Outside India [Sec. 10(7)]**

Any allowance or perquisite paid outside India by the Government to a citizen of India for rendering services outside India.

**Remuneration received for Co-operative Technical Assistance Programmes with an Agreement entered into by the Central Government in certain cases [Sec. 10(8)]**

**Remuneration received by Non-resident Consultant or Employee or Family Member of such Consultant [Sec. 10(8A), (8B) & (9)]**

**Death-cum-retirement-gratuity [Sec. 10(10)]**

Explained under the head salaries

**Commutation of Pension [Sec. 10(10A)]**

Explained under the head salaries

**Leave Encashment [Sec. 10(10AA)]**

Explained under the head salaries

**Workmen's Retrenchment Compensation [Sec. 10(10B)]**

Explained under the head salaries

**Compensation under Bhopal Gas Leak Disaster Act, 1985 [Sec. 10(10BB)]**

Compensation received by victims of Bhopal gas leak disaster is fully exempted

**Compensation for any Disaster [Sec. 10(10BC)]**

Any amount received or receivable from the Central Government or a State Government or a local authority by an individual or his legal heir by way of compensation on account of any disaster, except the amount received or receivable to the extent such individual or his legal heir has been allowed a deduction under this Act on account of any loss or damage caused by such disaster.

**Payment under Voluntary Retirement Scheme [Sec. 10(10C)]**

VRS compensation is not eligible for section 89(1) relief. (Explained under the head salaries)

**Tax paid by Employer on behalf of Employee on Non-monetary Perquisites u/s 17(2) [Sec. 10(10CC)]**

Explained under the head Salaries.

**Sum received under a Life Insurance Policy [Sec. 10(10D)]**

Any sum received under a life insurance policy including bonus on such policy is wholly exempt from tax. However, exemption is not available on -

1. any sum received u/s 80DD(3) or u/s 80DDA(3); or
2. any sum received under a Keyman insurance policy; or
3. any sum received under an insurance policy issued on or after 1-4-2012 in respect of which the premium payable for any of the years during the term of the policy exceeds 10%<sup>2</sup> of the actual capital sum assured.

**Payment from Statutory or Public Provident Fund [Sec. 10(11)]**

Amount withdrawn from the statutory provident fund is fully exempted.

**Payment from Sukanya Samriddhi Account [Sec. 10(11A)]**

any payment from an account, opened in accordance with the Sukanya Samriddhi Account Rules, 2014 made under the Government Savings Bank Act, 1873.

**Payment from Recognized Provident Fund [Sec. 10(12)]**

Fully exempted

**Payment from National Pension Trust [Sec. 10(12A) & 10(12B)]**



Any payment from the National Pension System Trust to an assessee on closure of his account or on his opting out of the pension scheme referred to in sec. 80CCD, to the extent it does not exceed 40% of the total amount payable to him at the time of such closure or his opting out of the scheme [Sec. 10(12A)]

Any payment from the National Pension System Trust to an employee under the pension scheme referred to in sec. 80CCD, on partial withdrawal made out of his account in accordance with the terms and conditions, specified under the Pension Fund Regulatory and Development Authority Act, 2013, to the extent it does not exceed 25% of the amount of contributions made by him [Sec. 10(12B)]

### **Payment from Approved Superannuation Fund [Sec. 10(13)]**

Any payment from an approved superannuation fund made -

- on the death of a beneficiary; or
- to an employee in lieu of or in commutation of an annuity on his retirement at or after a specified age or on his becoming incapacitated prior to such retirement; or
- by way of refund of contributions on the death of a beneficiary; or
- by way of refund of contributions to an employee on his leaving the service (otherwise than by retirement at or after a specified age or on his becoming incapacitated prior to such retirement) to the extent to which such payment does not exceed the contributions made prior to 1-4-1962 and any interest thereon.
- by way of transfer to the account of the employee under a pension scheme referred to in sec. 80CCD and notified by the Central Government

### **House Rent Allowance [Sec. 10(13A)]**

Explained under the head Salaries.

### **Notified Special Allowances [Sec. 10(14)]**

Any special allowance or benefit but not a perquisite is specially granted to meet certain expenditure incurred during employment. In this case actual expenditure incurred will be exempted on the fulfillment of certain condition mentioned in this section.

### **Interest on Securities [Sec. 10(15)]**

1. Interest, premium on redemption or other payment on notified securities, bonds or certificates
2. Interest in the hands of an individual and Hindu undivided family on Specified Capital Investment Bonds or Specified Relief Bonds

3. Interest on specified bonds to non resident or his nominees if such bonds are purchased by a non-resident Indian in foreign exchange; and
4. The interest and principal received in respect of such bonds, whether on their maturity or otherwise, is not allowable to be taken out of India. Interest on securities held by the Issue Department of the Central Bank of Ceylon;
5. Interest payable to any bank incorporated in a country outside India and authorized to perform central banking functions in that country on any deposits made by it, with the approval of the RBI, with any scheduled bank;
6. Interest payable on a loan advanced by the Nordic Investment Bank for an approved project;
7. Interest payable to the European Investment Bank for financial co-operation agreement;
8. Interest payable by a Government, local authority, certain industrial undertakings or financial institution on money borrowed before 1/6/2001
9. Interest on securities held by the Welfare Commissioner, Bhopal Gas Victims or deposits for the benefit of the victims of the Bhopal gas leak disaster.
10. Interest on Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 or deposit certificates issued under the Gold Monetization Scheme, 2015
11. Interest on specified bonds issued by a local authority or by a State Pooled Finance Entity.
12. Interest received by a non-resident or a person who is not ordinarily resident, in India on a deposit made on or after 1-4-2005 in an offshore banking unit referred in the Special Economic Zones Act, 2005

**Scholarship [Sec. 10(16)]**

Scholarships granted to meet the cost of education.

**Notes:**

- a. Cost of education also includes incidental expenses incurred for education.
- b. The exemption is irrespective of actual expenditure.

**Daily Allowance, etc. to MP and MLA [Sec. 10(17)]**

Any income by way of -

- a. Daily allowance received by any person by reason of his membership of Parliament or of any State Legislature or of any Committee thereof;
- b. Any allowance received by any person by reason of his membership of Parliament;
- c. Constituency Allowance received by any person by reason of his membership of State legislature;

**Awards and Rewards [Sec. 10(17A)]**

Any payment made, whether in cash or in kind -

- a. in pursuance of any award instituted in the public interest by the Central Government or any State Government or by any other approved body; or
- b. as a reward by the Central Government or any State Government for approved purposes.

**Pension to receiver of Gallantry Awards [Sec. 10(18)]**

Any income by way of -

- a. pension received by an individual who has been in the service of the Central or State Government and has been awarded "Param Vir Chakra" or "Maha Vir Chakra" or "Vir Chakra" or such other notified gallantry award ; or
- b. family pension received by any member of the family of such individual.

**Family Pension to Widow or Children of Armed Force [Sec. 10(19)]**

Family pension received by the widow or children or nominated heirs, of a member of the armed forces (including para-military forces) of the Union, where the death of such member has occurred in the course of operational duties, in such circumstances and subject to such conditions, as may be prescribed.

**Palace of Ex-ruler [Sec. 10(19A)]**

The annual value in respect of any one palace, which is in the occupation of an ex-ruler

**Income of Local Authority [Sec. 10(20)]**

Following income of a local authority is exempt -

- a. Income chargeable under the head Income from House Property, Capital Gains or Income from other Sources
- b. Income from the supply of commodities (other than water or electricity) or services, within its own jurisdiction
- c. Income from the supply of water services or electricity within or outside its jurisdiction

**Income of Scientific Research Association [Sec. 10(21)]**

Any income of a scientific research association [being approved for the purpose of Sec. 35(1)(ii)] or research association which has its object, undertaking research in social science or statistical research [being approved and notified for the purpose of Sec. 35(1)(iii)], is exempt provided such association—

- a. applies its income, or accumulates it for application, wholly and exclusively to the objects for which it is established; and
- b. invest or deposit its funds in specified investments.

**Income of News Agency [Sec. 10(22B)]**

Any income of specified news agency (Press Trust of India Ltd., New Delhi) set up in India solely for collection and distribution of news shall be exempt provided:

- a. The news agency applies its income or accumulates it for application solely for collection and distribution of news; and
- b. It does not distribute its income in any manner to its members.

**Income of Professional Institutions [Sec. 10(23A)]**

Any income (other than income chargeable under the head “Income from house property” or any income received for rendering any specific services or income by way of interest or dividends derived from its investments) of professional association shall be exempt provided -

- a. Such association or institution is established in India having as its object the control, supervision, regulation or encouragement of the profession of law, medicine, accountancy, engineering or architecture or other specified profession;
- b. Such association or institution applies its income, or accumulates it for application, solely to the objects for which it is established; and
- c. The association or institution is approved by the Central Government.

**Income of Regimental Fund [Sec. 10(23AA)]**

Any income received by any person on behalf of any Regimental Fund or Non-public Fund established by the armed forces of the Union for the welfare of the past and present members of such forces or their dependants is exempt.

**Income of specified Employee Welfare Fund [Sec. 10(23AAA)]**

**Income of specified Pension Fund [Sec. 10(23AAB)]**

**Income of trust for Development of Khadi and Village Industries [Sec. 10(23B)]**

**Income of Khadi and Village Industries Boards [Sec. 10(23BB)]**

**Income of body formed for Administration of Public Religious or Charitable Trusts [Sec. 10(23BBA)]**

Any income of anybody established under any Central, State or Provincial Act which provides for the administration of any public, religious or charitable trusts or endowments including Maths, Temples, Gurudwaras, Wakfs, Churches or other places of public religious worship or societies for religious or charitable purposes.

**Income of European Economic Community [Sec. 10(23BBB)]**

**Income of SAARC Fund [Sec. 10(23BBC)]**

**Income of ASOSAI-SECRETARIAT [Sec. 10(23BBD)]**

**Income of Insurance Regulatory Authority [Sec. 10(23BBE)]**

**Income of the Central Electricity Regulatory Commission [Sec. 10(23BBG)]**

**Income of the Prasar Bharati (Broadcasting Corporation of India) [Sec. 10(23BBH)]**

**Income of Certain Funds [Sec. 10(23C)]**

Any income received by any person on behalf of

1. The Prime Minister's National Relief Fund; [sec. 10(23C)(i)]
2. The Prime Minister's Fund (Promotion of Folk Art); [sec. 10(23C)(ii)]
3. The Prime Minister's Aid to Students Fund; [sec. 10(23C)(iii)]
4. The National Foundation for Communal Harmony; [sec. 10(23C)(iiia)]
5. The Swachh Bharat Kosh; [sec. 10(23C)(iiiiaa)]
6. The Clean Ganga Fund; [sec. 10(23C)(iiiiaaa)]
7. The Chief Minister's Relief Fund or the Lieutenant Governor's Relief Fund; [sec. 10(23C)(iiiiaaaa)]
8. Any other charitable fund or institution notified by the prescribed authority (subject to condition) [sec. 10(23C)(iv)]
9. Any trust or institution wholly for public religious purposes or wholly for public religious and charitable purposes notified by the prescribed authority (subject to conditions) [sec. 10(23C)(v)]
10. Any university or other education institutions, (wholly or substantially financed by Government or having annual receipt upto ` 1 crore) existing solely for education purposes and not for profit. [sec.10(23C)(iiiia), (iiiiaa) (vi)]
11. Any hospital or other institution (wholly or substantially financed by Government or having annual receipt up to ` 1 crore) for treatment of person suffering from illness or mental defectiveness or during convalescence or requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for profit. [sec.10(23C)(iiiiaa), (iiiiaa) and (viia)]

**Income of Mutual Fund [Sec. 10(23D)]**

Any income of -

- a. A Mutual Fund registered under the Securities and Exchange Board of India Act, 1992 or regulation made there under;
- b. A Mutual Fund set up by a public sector bank or a public financial institution or authorized by the Reserve Bank of India and subject to certain notified conditions.

**Income of Securitization Trust [Sec. 10(23DA)]**

Any income of a securitization trust from the activity of securitization.

- "Securitization" shall have the same meaning as assigned to it,
  - a. in regulation 2(1)(r) of the Securities and Exchange Board of India (Public Offer and Listing of Securitized Debt Instruments) Regulations, 2008 made under the Securities and Exchange Board of India Act, 1992 and the Securities Contracts (Regulation) Act, 1956; or
  - b. in clause (z) of sub-section (1) of section 2 of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; or
  - c. under the guidelines on securitization of standard assets issued by the Reserve Bank of India;
- "Securitization trust" shall have the meaning assigned to it in the Explanation below sec. 115TCA

**Income of Investor Protection Fund [Sec. 10(23EA)]**

Income (by way of contribution received from recognized Stock exchange and members thereof) of Investor Protection Fund set up by the recognized Stock Exchanges in India as the Central Government may by notification in Official Gazette specify shall be exempt.

**Income of Investor Protection Fund set up by Commodity Exchange [Sec. 10(23EC)]****Income of Investor Protection Fund of Depositories [Sec. 10(23ED)]**

Any income, by way of contributions received from a depository, of notified Investor Protection Fund set up in accordance with the regulations by a depository.

However, where any amount standing to the credit of the Fund and not charged to income-tax during any previous year is shared, either wholly or in part with a depository, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is so shared and shall, accordingly, be chargeable to income-tax.

**Income of Core Settlement Guarantee Fund [Sec. 10(23EE)]**

Any specified income of such Core Settlement Guarantee Fund, set up by a recognized clearing corporation in accordance with the regulations notified by the Central Government.

However where any amount standing to the credit of the Fund and not charged to income-tax during any previous year is shared, either wholly or in part with the specified person, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is so shared.

**Income of Ventures Capital Fund or Venture Capital Company [Sec 10(23FB)]**

Any income of a venture capital company or venture capital fund from investment in a venture capital undertaking.

**However**, w.e.f. A.Y. 2016-17, the exemption is not applicable to any income of a venture capital company or venture capital fund, being an investment fund specified in clause (a) of the Explanation 1 to sec. 115UB

**Non-business income of Investment Fund [Sec. 10(23FBA)]**

Any income of an investment fund other than the income chargeable under the head “Profits and gains of business or profession”.

**Income of Unit holder [Sec. 10(23FBB)]**

Any income, referred to in sec. 115UB, to a unit holder of an investment fund, being that proportion of income which is of the same nature as income chargeable under the head “Profits and gains of business or profession”.

♦ For the purposes of sec. 10(23FBA) and (23FBB), “investment fund” shall have the meaning assigned to it in clause (a) of the Explanation 1 to sec. 115UB.

**Income of Business Trust [Sec 10(23FC)]**

Any income of a business trust by way of

- a) interest received or receivable from a special purpose vehicle; or
- b) dividend referred to in sec. 115-O(7)

- “Special purpose vehicle” means an Indian company in which the business trust holds controlling interest and any specific percentage of shareholding or interest, as may be required by the regulations under which such trust is granted registration

**Income of Real Estate Investment Trust [Sec. 10(23FCA)]**

Any income of a business trust, being a real estate investment trust, by way of renting or leasing or letting out any real estate asset owned directly by such business trust.

**Distributed Income to unit holder of a Business Trust [Sec 10(23FD)]**

Any distributed income, referred to in section 115UA, received by a unit holder from the business trust, not being that proportion of the income which is of the same nature as the income referred to in **10(23FC)(a) or 10(23FCA)**

**Income of Trade Union [Sec. 10(24)]**

Any income chargeable under the heads “Income from house property” and “ Income from other sources” of -

- a. a registered union within the meaning of the Indian Trade Unions Act, 1926, formed primarily for the purpose of regulating the relations between workmen and employers or between workmen and workmen.
- b. an association of registered unions

**Income of specified Provident Funds, etc. (e.g. RPF, Superannuation fund, Approved gratuity fund) [Sec. 10(25)]**

**Income of Employees' State Insurance Fund [Sec. 10(25A)]**

**Income of Scheduled Tribe [Sec. 10(26)]**

Following income of member of a Scheduled Tribe is exempt –

- a. from any source in specified areas or States; or
  - b. by way of dividend or interest on any securities.
- provided he resides in specified area or States.

**Income of Sikkimese [Sec. 10(26AAA)]**

Following income of an individual, being a Sikkimese, is exempt:

- i. from any source in the State of Sikkim; or
- ii. by way of dividend or interest on securities:

**Note:** The exemption is not available to a Sikkimese woman who, on or after 1/4/2008, marries an individual who is not a Sikkimese.

**Income of an Agricultural produce Market Committee [Sec. 10(26AAB)]**

Income of an agricultural produce market committee or board constituted under any law for the time being in force for the purpose of regulating the marketing of agricultural produce is exempt.

**Income of Corporation for promoting the Interests of the Members of the Scheduled Castes or the Scheduled Tribe or Backward Classes [Sec. 10(26B)]**



**Income of Corporation for promoting Interest of Members of a Minority Community [Sec. 10(26BB)]**

**Income of Corporation for the Welfare and Economic Upliftment of Ex-servicemen [Sec. 10(26BBB)]**

**Income of a Co-operative Society for promoting the Interests of the Members of Scheduled Castes or Scheduled Tribes [Sec. 10(27)]**

**Income of specified Boards [Sec. 10(29A)]**

Any income accruing or arising to The Coffee Board; The Rubber Board; The Tea Board; The Tobacco Board; The Marine Products Export Development Authority; The Coir Board; The Agricultural and Processed Food Products Export Development Authority and The Spices Board.

**Subsidy received from Tea Board [Sec. 10(30)]**

Any subsidy received from or through the Tea Board under any scheme for replantation or replacement of tea bushes or for rejuvenation or consolidation of areas used for cultivation of tea as the Central Government may specify, is exempt

**Subsidy received from other Board [Sec. 10(31)]**

Any subsidy received from or through the concerned Board (like Coffee Boards, Rubber Board, etc.) under any such scheme for replantation or replacement of rubber plants, coffee plants, cardamom plants or plants for the growing of such other commodity or for rejuvenation or consolidation of areas used for cultivation of rubber, coffee, cardamom or such other specified commodity is exempt.

**Income of Minor [Sec. 10(32)]**

Income up to ` 1,500 is exempt in respect of each minor child whose income is clubbed u/s 64(1A).

**Income on Transfer of Units of US 64 [Sec. 10(33)]**

Any income arising from the transfer of a capital asset, being a unit of the Unit Scheme, 1964 where such transfer takes place on or after the 1st day of April, 2002.

**Dividend Income [Sec. 10(34)]**

Any income by way of dividend declared, paid or distributed by a domestic company.

The exemption is not available on dividend chargeable to tax in accordance with the provisions of sec. 115BBDA.

**Income of Shareholder on Buy-back of Shares [Sec. 10(34A)]**

Any income arising to an assessee, being a shareholder, on account of buy back of shares (not being listed on a recognised stock exchange) by the company, which pay additional income-tax u/s 115QA.

**Income from Units [Sec. 10(35)]**

Any income (other than income on transfer of unit) on the following units -

- a. income received in respect of the units of a Mutual Fund specified u/s 10(23D);
- b. income received in respect of units from the Administrator of the specified undertaking as defined in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002
- c. income received in respect of units from the company specified in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002

**Capital Gain on compulsory Acquisition of Urban Land [Sec. 10(37)]**

Refer Chapter Capital Gains

**Capital Gain on transfer under Land Pooling Scheme for Andhra Pradesh [Sec. 10(37A)]**

Refer Chapter Capital Gains

**Specified Income, Arising from any International Sporting Event [Sec. 10(39)]**

Any specified income, arising from any international sporting event held in India, to the person(s) notified by the Central Government in Official Gazette, if such international sporting event –

- a) is approved by the International body regulating the international sport relating to such event;
- b) has participation by more than 2 countries;
- c) is notified by the Central Government in the Official Gazette for the purpose of this clause.

**Note:** For the purpose of this clause “the specified income” means the income, of the nature and to the extent, arising from the international sporting event, which the Central Government may notify in this behalf.

**Reconstruction or Revival of Power Generation Subsidiary Company [Sec. 10(40)]**

Any income of any subsidiary company by way of grant or otherwise received from an Indian company, being its holding company engaged in the business of generation, transmission or distribution of power, if such receipts is for the settlement of dues in connection with reconstruction or revival of an existence business of power generation.

**Note:** The above clause is applicable if reconstruction or revival of any existing business of power generation is by way of transfer of such business to the Indian company notified u/s 80-IA (4)(v)(a)

**Income of a Non-profit Body or Authority specified by the Central Government [Sec. 10(42)]**

Any specified income arising to a body or authority which -

- has been established or constituted or appointed under a treaty or an agreement entered into by the Central Government with two or more countries or a convention signed by the Central Government;
- is established or constituted or appointed not for the purpose of profit;
- is notified by the Central Government.

**Reverse Mortgage [Sec. 10(43)]**

Any amount received by an individual as a loan, either in lump sum or in installment, in a transaction of reverse mortgage is exempt.

**New Pension Trust [Sec. 10(44)]**

Any income received by any person for, or on behalf of, the New Pension System Trust is exempt

**Allowance or Perquisite to member of Union Public Service Commission [Sec. 10(45)]**

Any allowance or perquisite, as may be notified by the Central Government in the Official Gazette in this behalf, paid to the Chairman or a retired Chairman or any other member or retired member of the Union Public Service Commission is exempt

**Specified Income of notified body or authority or Board or Trust or Commission [Sec. 10(46)]**

Any specified income arising to a body or authority or Board or Trust or Commission (by whatever name called), or a class thereof, which —

- a) has been established or constituted by or under a Central, State or Provincial Act, or constituted by the Central
- b) Government or a State Government, with the object of regulating or administering any activity for the benefit of the general public;
- c) b) is not engaged in any commercial activity; and
- d) c) is notified by the Central Government in the Official Gazette

**Infrastructure Debt Fund [Sec. 10(47)]**

Any income of notified infrastructure debt fund is exempt.

### **Import of Crude Oil [Sec. 10(48)]**

Any income received in India in Indian currency by a foreign company on account of sale of crude oil or other notified goods or service to any person in India provided:

- a. receipt of such income in India by the foreign company is pursuant to an agreement or an arrangement entered into by the Central Government or approved by the Central Government;
- b. having regard to the national interest, the foreign company and the agreement or arrangement are notified by the Central Government in this behalf; and
- c. the foreign company is not engaged in any activity, other than receipt of such income, in India.

### **Storage of Crude Oil [Sec. 10(48A)]**

Any income accruing or arising to a foreign company on account of storage of crude oil in a facility in India and sale of crude oil there from to any person resident in India provided:

- i. the storage and sale by the foreign company is pursuant to an agreement or an arrangement entered into by the Central Government or approved by the Central Government; and
- ii. having regard to the national interest, the foreign company and the agreement or arrangement are notified by the Central Government in this behalf.

### **Sale of leftover stock of crude oil [Sec. 10(48B)]**

Any income accruing or arising to a foreign company on account of sale of leftover stock of crude oil, if any, from the facility in India after the expiry of the agreement or the arrangement referred to sec. 10(48A) or on termination of the said agreement or the arrangement, in accordance with the terms mentioned therein, as the case may be.

### **Equalization Levy [Sec. 10(50)]**

Any income arising from any specified service provided on or after the date on which the provisions of Chapter VIII of the Finance Act, 2016 comes into force and chargeable to equalization levy under that Chapter.

### **Expenditure related to Exempted Income [Sec. 14A]**

For the purposes of computing the total income, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income, which does not form part of the total income under this Act. Where the AO is not satisfied with the correctness of the claim of such

expenditure by assessee, he can determine the disallowable expenditure in accordance with the method prescribed by the CBDT.

### **Special Provision in respect of Newly established Units in SEZ [Sec. 10AA]**

**Applicable to:** All assessee

#### **Conditions to be satisfied**

1. The assessee is an entrepreneur as defined in Sec.2(j) of SEZ Act, 2005.
2. The undertaking has begun or begins to manufacture or produce articles or things or provide services on or after 01/04/2005 but before 31/03/2020 in any SEZ.
3. **New Business:** Business should not be formed by splitting up or reconstruction of an existing business.

#### **Exception:**

However, this condition is not applicable when conditions given u/s 33B are satisfied, which are as follows -

- a) The business of an industrial undertaking carried on in India is discontinued in any previous year by reason of extensive damage to, or destruction of, any building, machinery, plant or furniture owned by the assessee being used for business purpose.
  - b) Such damage was caused due to -
    - i) flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature; or
    - ii) riot or civil disturbance; or
    - iii) accidental fire or explosion; or
    - iv) action by an enemy or action taken in combating an enemy (whether with or without a declaration of war),
  - c) Such business is re-established, reconstructed or revived by the assessee at any time before the expiry of 3 years from the end of previous year in which such damage was caused.
4. **New Plant and Machinery:** Such undertaking should not be formed by transfer of machinery or plant previously used for any purpose.

#### **Exception:**

- a) A plant or machinery is deemed as a new asset if the following conditions are satisfied -
  - i) Such plant or machinery is imported into India;
  - ii) Depreciation on such asset has not been allowed under this Act to any person; and
  - iii) The assessee was the first user of such asset in India.

b) Where the total value of old plant and machinery transferred to the new business does not exceed 20% of total value of plant and machinery used in such business, then this condition is deemed to be satisfied.

**5.** A report of a chartered accountant in Form 56F must be filed with the return of income certifying that the deduction has been correctly claimed.

# MODULE II

## INCOME FROM SALARIES

### BASIC ELEMENTS OF SALARY

- Payer and payee must have employer and employee (or Master & Servant) relationship; and
- Payment must have been made by the employer in such capacity.

#### Employer-employee relationship

A payment can be construed as salary only if the payer is the employer and payee is the employee of the payer.

- **Criteria for employer-employee relationship:** The key criteria to hold this relationship is that, employee is always bound to work as per direction and supervision of the employer.
- **Payment in employer's capacity:** To treat any payment as salary it is necessary that payer, being the employer, must have made the payment in such (employer's) capacity.
- **Contract of service vs contract for service:** In "contract of service", the employer can direct and control the duties and the manner of performance of employee hence employer-employee relationship exists in such contract. However, in case of "contract for service" the contractee can simply decide and quote the object or target to be achieved but cannot decide or direct the manner of performance.
- **Agent and Principal:** If a person is acting as an agent for his principal, any commission or remuneration earned by the agent is not taxable under the head "Salaries". This is because, an agent is not the employee of his principal.
- **Salary received by a partner** from its firm shall not be taxable as salary, because there is no employer-employee relationship between the firm and the partner. Such salary shall be taxable under the head "Profits & gains of business or profession".
- **Salary received by proprietor from his proprietorship firm** is not an income. As proprietor and proprietorship firm are the same person and no one can earn from himself.
- **Remuneration to director** from his company can be treated as salary only if the director is employee of the company, otherwise the same shall be taxable under the head "Income from other sources".

**Note:** Directors' sitting fee is taxable under the head "Income from other sources".

- **Pension received by the widow** or legal heir of deceased employee is not taxable as salary as no employer-employee relationship exists between the payer and the payee. However such amount shall be taxable under the head “Income from other sources”.
- **Remuneration received by Judges** is taxable under the head “Salaries” even though they are not having any employer.

Concluding the above discussions, a payment received for services rendered, from a person other than employer, is not taxable under the head “Salaries” but may be taxed under the head “Profits & gains of business or profession” or “Income from other sources”.

### ***ILLUSTRATION***

State whether the following receipts should be treated as salary or not?

- A teacher receives emoluments in kind from school in which he teaches.

Yes, it is immaterial whether salary has been received in cash or in kind.

- A teacher of a college receives fees from a University for checking answer sheets.

No, as employer – employee relationship does not exist between payer and payee. (College-teacher is not the employee of the University). Such receipt shall be taxable under the head ‘Income from other sources’.

- A payment made to the Member of the Parliament or the State legislature.

No, as employer-employee relationship does not exist.

A member of the Parliament or the State legislature is not treated as employee of the Government. Payment received by them shall be taxable under the head “Income from other sources”.

### **DEFINITION OF SALARY [SEC. 17(1)]**

As per sec. 17(1) of the Income-tax Act, 1961, salary includes the following:

- Wages;
- Any annuity or pension;
- Any gratuity;
- Any fees, commission, perquisite or profits in lieu of or in addition to any salary or wages;
- Any advance of salary;
- Any payment received in respect of any period of leave not availed of by the assessee;
- The portion of the annual accretion in any previous year to the balance at the credit of an employee, participating in recognized provident fund, to the extent it is taxable;



- h) Transferred balance in a Recognized Provident Fund to the extent it is taxable.
- i) Contribution made by the employer in the previous year, to the account of an employee under a pension scheme referred to in sec. 80CCD [National Pension Scheme and Atal Pension Yojana].

### **BASIS OF CHARGE [SEC. 15]**

Salary is chargeable to tax either on 'due' basis or on 'receipt' basis, whichever is earlier. Hence, taxable salary includes:

**a) Advance salary** (on 'receipt' basis): Salary paid in advance is taxable under the head 'Salaries' in the year of receipt.

**Note:** Such advance salary shall not be included again in the total income when the salary becomes due.

**b) Outstanding salary** (on 'due' basis): Salary falling due is taxable under the head 'Salaries' in the year in which it falls due.

**Note:** Such due salary shall not be included again in the total income when it is received.

**c) Arrear salary:** Any increment in salary with retrospective effect which have not been taxed in the past, such arrears will be taxed in the year in which it is allowed. Arrear salary are taxable on receipt basis.

#### **Advance salary vs Advance against salary**

'Advance salary' is taxable u/s 17(1)(e) whereas 'Advance against salary' is treated as loan hence, not taxable under the head "Salaries".

#### **Place of accrual of salary**

Salary which is received in India or earned in India shall be taxable in hands of all assessee whether resident or non resident in India. Salary is deemed to be earned in India provided -

- (a) The service is rendered in India;
- (b) The rest period or leave period, which is preceded and succeeded by the service rendered in India and forms part of the service contract of employment.

#### **Principles of salary**

1. Employee employer relationship
2. Salary from a former employer
3. Place of accrual of salary income
4. Foregoing salary

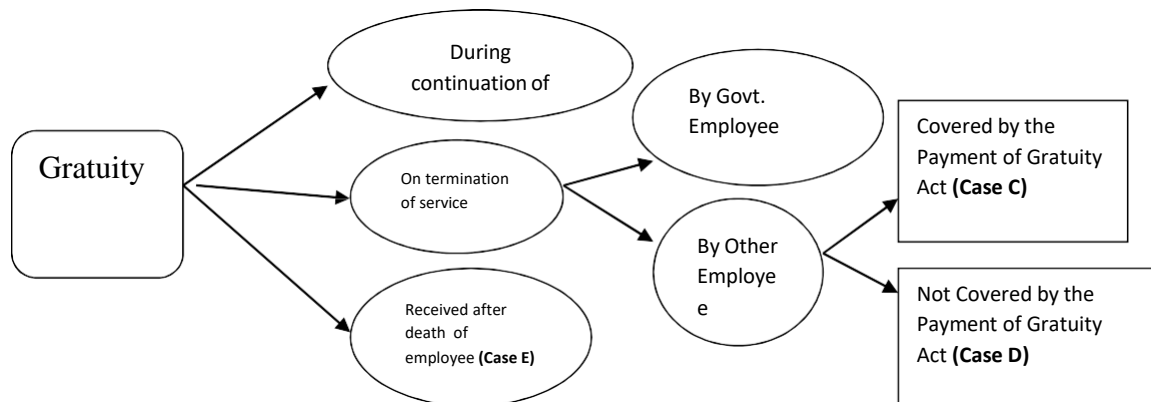
5. Tax free salary
6. Surrender of salary
7. Accrual basis
8. Payment made after termination

### Scope of salary

1. Basic salary or wages
2. Advance pay
3. Arrears of salary
4. Dearness pay
5. Annuity
6. Pension

### GRATUITY

Gratuity is a retirement benefit given by the employer to the employee in consideration of past services. Sec. 10(10) deals with the exemptions from gratuity income. Such exemption can be claimed by a salaried assessee. Gratuity received by an assessee other than employee shall not be eligible for exemption u/s 10(10). E.g. Gratuity received by an agent of LIC of India is not eligible for exemption u/s 10(10) as agents are not employees of LIC of India.



#### Case A: Gratuity received during continuation of service

Gratuity received during continuation of service is fully taxable in the hands of all employee (whether Government or non-Government employee).

**Case B: Gratuity received at the time of termination of service by Government employee**

Gratuity received at the time of termination of service by Government employee is fully exempt from tax u/s 10(10)(i).

**Tax point:** Government employee, here, includes employee of the Central or the State Government or local authority but does not include employee of statutory corporation.

**Case C: Gratuity received at the time of termination of service by non-government (including foreign government) employee, covered by the Payment of Gratuity Act**

In such case, minimum of the following shall be exempted from tax u/s 10(10)(ii):

1. Actual Gratuity received;
2. ₹ 20,00,000; or
3. 15 working days salary for every completed year of service

[Arithmetically,  $15/26 \times \text{Completed year of service} \times \text{Salary p.m.}$ ]

**Notes**

- a) Completed year of service includes any fraction in excess of 6 months. (e.g. 7 years 9 months will be treated as 8 years; 7 years 5 months will be treated as 7 years and 7 years 6 months will be treated as 7 years).
- b) Salary here means Basic + DA, last drawn

**ILLUSTRATION**

Ashok, an employee of ABC Ltd., receives ₹ 2,05,000 as gratuity under the Payment of Gratuity Act, 1972. He retires on 10th September, 2018 after rendering service for 35 years and 7 months. The last drawn salary was ₹ 2,700 per month. Calculate the amount of gratuity chargeable to tax.

Particulars	Details (₹)	Amount (₹)
Gratuity received		2,05,000
Less: Minimum of the following is exempted as per Sec 10(10)(ii):		
(a) Actual gratuity received	2,05,000	
(b) Statutory Amount	20,00,000	
(c) $15/26 \times \text{completed year of service} \times \text{salary p.m.}$ [ $15/26 \times 36 \times ₹ 2,700$ ]	56,077	56,077
<b>Taxable Gratuity</b>		<b>1,48,923</b>

**Case D: Gratuity received at the time of termination of service by non-government employee (including foreign government employee) not covered under the Payment of Gratuity Act**

Gratuity received at the time of termination of service by non-government employee being not covered under the Payment of Gratuity Act shall be exempted from tax u/s 10(10)(iii) to the extent of lower of the following:

1. Actual Gratuity received;
2. ` 10,00,000; and
3.  $1/2 \times \text{Completed year of service} \times \text{Average Salary p.m.}$

**Notes**

- a) While calculating completed year of service *ignore* any fraction of the year. (e.g. 7 years 9 months will be treated as 7 years only)
- b) Average Salary here means, Basic + DA# + Commission (being a fixed percentage on turnover) being last 10 months average salary, immediately preceding the month of retirement. (E.g. If an employee retires on 18/11/2018 then 10 months average salary shall be a period starting from Jan' 2018 and ending on Oct' 2018).

# If DA is not forming a part of retirement benefit then the same shall not be included in salary for above purpose. However, DA itself shall be fully taxable.

**ILLUSTRATION**

Mr. Old man retired from his job after 29 years 6 months and 15 days of service on 17/12/2018 and received gratuity amounting ` 4,00,000. His salary at the time of retirement was basic ` 6,000 p.m., dearness allowance ` 1,200 p.m., House rent allowance ` 2,000, Commission on turnover 1%, Commission on profit ` 5,000. He got an increment on 1/4/2018 of ` 1,000 p.m. in Basic. Turnover achieved by assessee ` 1,00,000 p.m. Calculate his taxable gratuity if he is a —

- a) Government employee
- b) Non-Government employee, covered by the Payment of Gratuity Act;
- c) Non-Government employee not covered by the Payment of Gratuity Act

**d) Solution**

- e) a) Government employee: Taxable amount: Nil as per section 10(10)(i).
- f) b) Other cases:
- g) Computation of taxable gratuity of Mr. Oldman for the A.Y. 2019-20

Particulars	Case (b)		Case (c)	
	Details (₹)	Amount (₹)	Details (₹)	Amount (₹)
Gratuity received		4,00,000		4,00,000
Less: Min. of the following is exempted u/s 10(10)				
Actually gratuity received	4,00,000		4,00,000	
Statutory amount	2000000		1000000	
$15/26 \times$ completed year of service $\times$ salary p.m. [ $15/26 \times 30 \times 7,200$ ]	1,24,615	1,24,615		
$1/2 \times$ completed year of service $\times$ salary p.m. [ $1/2 \times 29 \times 8,000$ ]			1,16,000	1,16,000
<b>Taxable Gratuity</b>		<b>2,75,385</b>		<b>2,84,000</b>

#### Case E: Gratuity received after death of employee

The Act is silent on treatment of gratuity received after death of employee. However, on following grounds, it can be concluded that gratuity received by a legal heir shall not be taxable in the hands of the recipient -

- A lump sum payment made gratuitously to widow or legal heir of employee, who dies while in service, by way of compensation or otherwise is not taxable under the head “Salaries”. [Circular No.573, Dated 21.08.1990]
- Unutilized deposit under the capital gains deposit account scheme shall not be taxable in the hands of legal heir. [Circular No.743 dated 6/5/1996]
- Legal representative is not liable for payment of tax on income that has not accrued to the deceased till his death.
- Leave salary paid to the legal heir of deceased employee is not taxable as salary. [Circulars Letter No. F.35/1/65- IT(B), dated 5/11/1965]. Further, leave salary by a legal heir of the Government employee who died in harness is not taxable in the hands of the recipient [Circulars No.309, dated 3/7/1981].

## ILLUSTRATION

Mrs. X is working with ABC Ltd. since last 30 years 9 months. Her salary structure is as under:

Basic ` 5,000 p.m. Dearness allowance ` 3,000 p.m.

On 15/12/2018, she died. State the treatment of gratuity in following cases:

**Case 1:** Mrs. X retired on 10/12/2018 & gratuity ` 4,00,000 received by her husband (legal heir) as on 18/12/2018.

**Case 2:** Husband of Mrs. X received gratuity on 18/12/2018 falling due after death of Mrs. X.

Mrs. X is covered by the Payment of Gratuity Act.

## Solution

In **Case 1**, Computation of taxable gratuity in hands of Mrs. X for the A.Y. 2019-20

Particulars	Details	Amount
Total Gratuity received		4,00,000
Less: Minimum of the following is exempted as per Sec 10(10)(ii):		
Actual gratuity received	4,00,000	
Statutory Amount	20,00,000	
$15/26 \times \text{completed year of service} \times \text{salary p.m.}$ [ $15/26 \times 31 \times ` 8,000$ ]	1,43,077	1,43,077
<b>Taxable Gratuity</b>		<b>2,56,923</b>

## LEAVE SALARY ENCASHMENT

As per service contract and discipline, normally, every employee is allowed certain period of leave (with pay) every year. Such leave may be availed during the year or accumulated by the employee. The accumulated leave lying to the credit of an employee may be availed subsequently or encashed. When an employee receives an amount for waiving leave lying to his credit, such amount is known as leave salary encashment.

### Case A: Leave salary received during continuation of service

Leave salary during continuation of service is fully taxable in the case of the Government employee as well as other employees [Sec. 17(1)(va)].

### Case B: Leave salary received by Government employee on termination of service

At the time of termination of service, leave salary received by the Central or State Government employee is fully exempted u/s 10(10AA)(i).

**Tax point:** Government employee here does not include employee of local authority or public sector undertaking or foreign Government employee.

### **Case C: Leave salary received by non-Government employee on termination of service**

At the time of termination of service, leave salary received by a non-Government employee (including employee of foreign Government, local authority, public sector undertaking) is exempted to the minimum of the following u/s 10(10AA)(ii):

- a) Actual amount received as leave salary
- b) ` 3,00,000/-
- c)  $10 \times$  Average salary p.m.
- d) To the maximum of 30 days (normally taken as 1 month) average salary<sup>1</sup> for every completed year of service<sup>2</sup>, subject to deduction for actual leave availed during the tenure of service.

Academically:  $[(1 \times \text{completed year of service}) - \text{leave actually taken in terms of month}] \times \text{average salary p.m.}]$

<sup>1</sup> Average salary means Basic + DA<sup>#</sup> + Commission (as a fixed percentage on turnover) being last 10 months average salary ending on the date of retirement or superannuation. (e.g. if an employee retires on 18/11/2018 then 10 months average salary shall be a period starting from 19th Jan' 2018 and ending on 18th Nov' 2018).

<sup>#</sup> If DA is not forming a part of retirement benefit then the same shall not be included in salary for the above purpose. However, DA itself shall be fully taxable.

2. While calculating completed year of service, ignore any fraction of the year. E.g. 10 years 9 months shall be taken as 10 years.

### ***ILLUSTRATION***

- a) Mr. Bhanu is working in Zebra Ltd. since last 25 years 9 months. Company allows 2 months leave for every completed year of service to its employees. During the job, he had availed 20 months leave. At the time of retirement on 10/8/2018, he got ` 1,50,000 as leave encashment. As on that date, his basic salary was ` 5,000 p.m., D.A. was ` 2,000 p.m., Commission was 5% on turnover + ` 2,000 p.m. (Fixed p.m.). Turnover effected by the assessee during last 12 months (evenly) ` 5,00,000. Bhanu got an increment of ` 1,000 p.m. from 1/1/2018 in basic and ` 500 p.m. in D.A. Compute his taxable leave encashment salary.
- b) How shall your answer differ if the assessee had taken 2 months leave instead of 20 months, during his continuation of job.

## Solution

### Working

1. Completed year of service: 25 years 9 months = 25 years
2. As per sec. 3(35) of the General Clauses Act, 1897, month shall mean a month reckoned according to the British calendar e.g. the period commencing from 7th September & end on 6th October shall be a month.
3. Salary here means Basic + Dearness Allowance + Commission on turnover (last 10 months average from the date of retirement)

Particulars	Oct' 17 21 days ( <sup>o</sup> )	Nov ( <sup>o</sup> )	Dec ( <sup>o</sup> )	Jan' 18 ( <sup>o</sup> )	Feb ( <sup>o</sup> )	Mar ( <sup>o</sup> )	April ( <sup>o</sup> )	May ( <sup>o</sup> )	June ( <sup>o</sup> )	July ( <sup>o</sup> )	Aug 10 Days ( <sup>o</sup> )	Total
Basic	2,710	4,000	4,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	1,613	47,323
D.A.	1,016	1,500	1,500	2,000	2,000	2,000	2,000	2,000	2,000	2,000	645	18,661
Commission	$500000 \times 5\% \times 10/12$											20,833
Total												86,817
Average salary i.e. ` 86,817 / 10 months												8,682

Monthly fixed commission is irrelevant. Commission as fixed percentage of turnover is to be considered.

Computation of taxable leave encashment salary of Mr. Bhanu for the A. Y. 2019-20

Particulars	Case (a)		Case (b)	
	Details ( <sup>o</sup> )	Amount ( <sup>o</sup> )	Details ( <sup>o</sup> )	Amount ( <sup>o</sup> )
Leave encashment received		1,50,000		1,50,000
Less: Min. of the following is exempted u/s 10(10AA)(ii):				
a) Actual amount received	1,50,000		1,50,000	
b) Statutory Amount	3,00,000		3,00,000	
c) 10 months $\times$ Av. Salary p.m. (10 $\times$ 8,682)	86,820		86,820	
d) [ $\{1 \times \text{completed year of service} - \text{Leave taken}\} \times \text{salary p.m.}$ ]				
$\wedge \{1 \times 25 - 20\} \times 8,682 \# \{1 \times 25 - 2\} \times 8,682$	43,410 <sup>^</sup>	43,410	1,99,686 <sup>#</sup>	86,820
<b>Taxable Leave Encashment</b>		<b>1,06,590</b>		<b>63,180</b>

### ILLUSTRATION

Mr. Das retired on 31/3/2019. At the time of retirement, 18 months leave was lying to the credit of his account. He received leave encashment equivalent to 18 months Basic salary ` 1,26,000. His employer allows him 1½ months leave for every completed year of service. During his tenure, he



availed of 12 months leave. At the time of retirement, he also gets D.A. ₹ 3,000. His last increment of ₹ 1,000 in basic was on 1/4/2018. Find taxable leave encashment.

### Solution

#### Working

**1. Calculation of completed year of service:** Employee has received 18 months leave encashment on termination of service as well he had enjoyed leave of 12 months during his tenure. That means he had received a leave benefit of 30 months. Since leave allowed by employer is 1½ months for every completed year of service, this signifies that Mr. Das had completed 20 years (being 30/1½) of service.

**2. Salary here means, Basic + DA + Commission, being last 10 months average from the date of retirement. There is no increment in last 10 months (last increment was on 1/4/2018) and there is no commission, hence Av. Salary = ₹ 7,000 (i.e. ₹ 1,26,000/18) + ₹ 3,000 = ₹ 10,000 p.m.**

#### Computation of taxable leave encashment of Mr. Das for the A.Y. 2019-20

Particulars	Details (₹)	Amount (₹)
Leave Encashment received		1,26,000
Less: Minimum of the following is exempt u/s 10(10AA)(ii):		
(a) Actual amount received	1,26,000	
(b) Statutory Amount	300000	
(c) 10 months × Av. Salary p.m. (10 × 10,000)	100000	
(d) {1 × completed year of service - Leave taken} × Avg. salary p.m. [1 × 20 - 12] × ₹ 10,000	80000	80000
<b>Taxable Leave Encashment</b>		<b>46,000</b>

#### Case D: Leave salary paid to the legal heir

Leave salary paid to the legal heir of deceased employee is not taxable. [Circulars Letter No. F.35/1/65-IT(B), dated 5/11/1965]. Further, leave salary received by a legal heir of the Government employee who died in harness is not taxable in the hands of the recipient [Circulars No.309, dated 3/7/1981].

### RETRENCHMENT COMPENSATION

Retrenchment means cancellation of contract of service by employer.

**Tax Treatment [Sec. 10(10B)]:** Any compensation received by a worker at the time of retrenchment is exempted to the extent of minimum of the following:

- a) Actual amount received;
- b) ` 5,00,000; or
- c) An amount calculated in accordance with the provisions of sec. 25F(b) of Industrial Dispute Act, 1947 (Under the said Act a workman is entitled to retrenchment compensation equivalent to 15 days' average pay, for every completed year of service or any part thereof in excess of 6 months).

**COMPENSATION RECEIVED AT THE TIME OF VOLUNTARY RETIREMENT [SEC. 10(10C)]**

If an employee accepts retirement willingly in lieu of compensation then such retirement is known as Voluntary Retirement. Voluntary retirement compensation *received or receivable* by an employee is eligible for exemption subject to the following conditions -

**Conditions for exemption**

1. Compensation is received from specified employer#
2. Compensation is received as per Voluntary Retirement Scheme (VRS) framed in accordance with prescribed guidelines\*

**Amount of exemption**

Exemption shall be minimum of the following -

- a) Actual amount received as per guidelines; or
- b) ` 5,00,000.

**\*Guidelines [Rule 2BA]**

1. Scheme (VRS) must be applicable to all employees (other than director) who have either completed age of 40 years or has completed 10 years of service. (This condition is, however, not applicable in the case of an employee of a public sector company)
2. Such scheme must be framed to reduce the number of employees.
3. The vacancy caused by VRS is not to be filled up.
4. The retiring employee is not to be employed in another company or concern belonging to the same management.
5. The amount of compensation does not exceed
  - the amount equivalent to 3 months salary for each completed year of service; or
  - salary at the time of retirement multiplied by the balance month of service left.

**Note:** Salary here means [Basic + DA (if forms a part of retirement benefit) + fixed percentage of commission on turnover], last drawn

#### ALLOWANCES

Allowance means fixed quantum of money given regularly in addition to salary to meet particular requirement. The name of particular allowance may reveal the nature of requirement, e.g. House Rent Allowance, Tiffin Allowance, Medical Allowance etc.

Allowances at a glance

General Allowance	House Rent Allowance, City Compensatory Allowance, Tiffin Allowance, Medical Allowance, Servant Allowance, Entertainment Allowance
Allowance u/s 10(14)(i), deductions from which depends upon actual expenditure [Rule 2BB(1)]	Travel or Transfer allowance, Daily Allowance, Conveyance Allowance, Assistant Allowance, Professional Development Allowance, Uniform Allowance
Allowance u/s 10(14)(ii), deductions from which do not depend upon actual expenditure [Rule 2BB(2)]	Few of these allowances are: Children Education Allowance, Children Hostel Allowance, Truck Drivers' Allowance, Transport Allowance, Tribal Areas Allowance, Special Compensatory Allowance, Border Area Allowance, etc.
Allowances to a Government employee being an Indian citizen working outside India [Sec. 10(7)]	
Allowances received from UNO	
Compensatory allowance under Article 222(2) of the Constitution	
Allowance to judges of the High Court and the Supreme Court	
Allowances to teacher / professor from SAARC Member States	
Allowance or Perquisite to member of Union Public Service Commission [Sec. 10(45)]	
Any other Allowance	

#### Tax treatment of various allowances are as follows

Following allowances are fully taxable:

Allowances	Meaning
<b>City Compensatory Allowance</b>	An allowance to meet personal expenses, which arise due to special circumstances, or to compensate extra expenditure by reason of posting at a particular place.
<b>Tiffin Allowance</b>	An allowance to meet the expenditure on tiffin, refreshment etc.
<b>Medical Allowance</b>	An allowance to meet the expenditure on medical treatment etc.
<b>Servant Allowance</b>	An allowance to meet the expenditure of servant for personal purpose.
<b>Non-practicing Allowance</b>	Allowance given to professionals to compensate them for restriction on private practice.
<b>Warden or Proctor Allowance</b>	Allowances given to employees of educational institutions for working as warden of the hostel or working as proctor in the institutions.

<b>Deputation Allowance</b>	Allowances given to an employee, when he is sent on deputation for a temporary period from his permanent place of service.
<b>Entertainment Allowance</b>	It is an allowance to meet expenditure on entertainment, by whatever name called. Government employee can claim deduction u/s 16(ii) discussed later in this chapter.

**House rent allowance (HRA) [Sec. 10(13A) and rule 2A]**

An allowance to meet the expenses in connection with the rent of the house, by whatever name called.

**Tax Treatment:** Minimum of the following is exempted from tax:

- a. Actual HRA received.
  - b. An amount equal to 50% of salary<sup>1</sup> (when house is situated in a metro city) or 40% of salary<sup>1</sup> (when house is situated in any other place) for the relevant period
  - c. The excess of rent paid over 10% of salary<sup>1</sup>. [Arithmetically, (Rent Paid – 10% of Salary)]
- <sup>1</sup>. Salary here means: Basic + D.A. (if it forms a part of retirement benefit) + Commission as a fixed % on turnover.

**Notes**

- a) Salary shall be determined on due basis for the period for which the employee occupies rented accommodation in the previous year and gets HRA.
- b) Exemption is not available if employee lives in his own house, or in a house for which he does not pay any rent.
- c) For criteria of 50% or 40% of salary as deduction, place of employment is not significant but place where the house is situated is important.
- d) Deduction from HRA depends on Salary of the employee, Amount of HRA, place of residence (not place of employment), rent paid by the employee.

**ILLUSTRATION**

X, a resident of Ajmer, receives ₹ 48,000 as basic salary during the previous year 2018-19. In addition, he gets ₹ 4,800 as dearness allowance forming part of basic salary, 7% commission on sales made by him (sale made by X during the relevant previous year is ₹ 86,000) and ₹ 6,000 as house rent allowance. He, however, pays ₹ 5,800 as house rent. Determine the quantum of exempted house rent allowance.

## Solution

Computation of taxable house rent allowance of X for the A.Y. 2019-20

Particulars	Details (₹)	Amount (₹)
House Rent Allowance Received		6,000
Less: Minimum of the following being exempted u/s 10(13A)		
a) Actual Amount Received	6,000	
b) 40% of Salary (Note)	23,528	
c) Rent paid – 10% of salary [₹ 5,800 – ₹ 5,882]	Nil	Nil
<b>Taxable House Rent Allowance</b>		<b>6,000</b>

### Note: Salary for the purpose of HRA

Basic salary ₹ 48,000

Dearness Allowance ₹ 4,800

Commission (7% of ₹ 86,000) ₹ 6,020

Total ₹ 58,820

Hence, exemption u/s 10(13A) is Nil.

## ILLUSTRATION

Compute the taxable house rent allowance of Mr. Abhijeet from the following data:

- Basic Salary ₹ 5,000 p.m., D.A. ₹ 2,000 p.m., HRA ₹ 4,000 p.m., Rent paid ₹ 4,000 p.m. in Pune.
- On 1/07/2018, there is an increment in Basic salary by ₹ 1,000.
- On 1/10/2018, employee hired a new flat in Kolkata at the same rent as he was posted to Kolkata.
- On 1/01/2019, employee purchased his own flat and resides there.

## Solution

Computation of taxable house rent allowance of Mr. Abhijeet for the A.Y. 2019-20

Particulars	Details (₹)	Amount (₹)	Amount (₹)
House Rent Allowance Received (from 1.4.2018 to 30.6.2018)		12,000	
Less: Minimum of the following being exempted u/s 10(13A)			
(a) Actual Amount Received	12,000		
(b) 40% of Salary [(₹ 5,000 + ₹ 2,000) × 3]	8400		
(c) Rent paid – 10% of salary (₹ 12,000 – ₹ 2,100)	9900	8400	3600
House Rent Allowance Received (from 1.7.2018 to 30.9.2018)		12,000	
Less: Minimum of the following being exempted u/s 10(13A)			
(a) Actual Amount Received	12,000		

b) 40% of Salary [ $\text{C}^{\wedge} 6,000 + \text{` } 2,000) \times 3]$	9600		
(c) Rent paid – 10% of salary ( $\text{C}^{\wedge} 12,000 - \text{` } 2,400)$	9600	9600	2400
House Rent Allowance Received (from 1.10.2018 to 31.12.2018)		12,000	
Less: Minimum of the following being exempted u/s 10(13A)			
a) Actual Amount Received	12,000		
(b) 50% of Salary [ $\text{C}^{\wedge} 6,000 + \text{` } 2,000) \times 3]$	12,000		
c) Rent paid – 10% of salary ( $\text{C}^{\wedge} 12,000 - \text{` } 2,400)$	9600	9600	2400
House Rent Allowance Received (from 1.1.2019 to 31.3.2019)			
(Fully taxable as assessee resides in his own house)			12000
<b>Taxable House Rent Allowance</b>			20400

#### Special allowance exempt u/s 10(14)

Allowances, deduction from which depends on actual expenditure [Sec. 10(14)(i)]

Allowance	Meaning
<b>Travel or transfer Allowance</b>	An allowance, by whatever name called, to meet the cost of travel on tour. Cost of travel includes any sum paid in connection with transfer, packing and transportation of personal effects on such transfer.
<b>Daily Allowance</b>	An allowance, by whatever name called, granted on tour (or for the period of journey in connection with transfer) to meet the ordinary daily charges incurred by employee on account of absence from his normal place of duty.
<b>Conveyance Allowance</b>	Any allowance granted to meet the expenditure on conveyance in performance of duties of the office, provided free conveyance is not provided by the employer. <b>Taxpoint:</b> Expenditure for covering the journey between office and residence is not treated as expenditure in performance of duties of office and consequently not covered under this allowance. (Refer Transport allowance)
<b>Helper / Assistant Allowance</b>	Any allowance (by whatever name called) to meet the expenditure of assistant or helper, provided such helper is appointed for the performance of duties of an office. <b>Taxpoint:</b> Servant allowance is fully taxable.
<b>Research Allowance</b>	Any allowance, by whatever name called, granted to encourage academic, research and other professional pursuits. This allowance may also be termed as Professional Development / Academic allowance
<b>Uniform Allowance</b>	Any allowance, by whatever name called, to meet the expenditure on purchase or maintenance of uniform wear, during the performance of duties of an office. <b>Taxpoint:</b> Uniform allowance is different from Dress allowance. Dress allowance is fully taxable.

**Tax Treatment of aforesaid allowances:**

Minimum of the following shall be exempted:

- a) Actual amount received; or
- b) Actual expenditure incurred for such purpose.

**Allowances, deduction from which do not depend on actual expenditure [Sec. 10(14)(ii)]**

**Children Education Allowance**

An allowance to meet the expenses in connection with education of children, by whatever name called.

**Treatment:** Minimum of the following is exempted from tax -

- a) ` 100 per month per child (to the maximum of two children)
- b) Actual amount received for each child (to the maximum of two children)

**Children Hostel Allowance**

An allowance to meet the hostel expenses of children, by whatever name called.

**Treatment:** Minimum of the following is exempted from tax -

- a) ` 300 per month per child (to the maximum of two children)
- b) Actual amount received for each child (to the maximum of two children)

**Notes for Children Education Allowance and Hostel Allowance:**

- a) Child includes adopted child, step-child but does not include illegitimate child and grandchild.
- b) Child may be major or minor child.
- c) Deduction is available irrespective of actual expenditure incurred on education of child.

**ILLUSTRATION**

Mr. Laloo Singh, received education allowance of ` 80 p.m. for his 1st child, ` 90 p.m. for his 2nd child and ` 120 p.m. for his 3rd child. He also received hostel allowance of ` 1,000 p.m. None of his children are studying. Find taxable Children Education Allowance and Hostel allowance.

## Solution

Computation of taxable children education allowance for Mr. Laloo Singh for the A.Y. 2019-20

Particulars	Details	Amount
Hostel allowance		12,000
Less: Exempted ( $\text{₹ } 300 \times 2 \times 12$ )	7,200	4,800
Children Education allowance [ $(\text{₹ } 80 \times 12) + (\text{₹ } 90 \times 12) + (\text{₹ } 120 \times 12)$ ]		3,480
Less: Exempted $\{(\text{₹ } 100 + \text{₹ } 90) \times 12\}$	2,280	1,200
<b>Taxable Allowance</b>		<b>6,000</b>

**Note:** Education allowance is allowed for any two children of assessee therefore education allowance of first child (which is the lowest one i.e.  $\text{₹ } 80$  only) is not considered, to avail higher deduction.

Particulars	Mr. X		Mrs. X	
	Details (₹)	Amount (₹)	Details (₹)	Amount (₹)
Education allowance ( $\text{₹ } 500 \times 12$ )	6,000		6000	
Less: Exemption ( $\text{₹ } 100 \times 12 \times 2$ )	2,400	3,600	2,400	3,600
Hostel Allowance ( $\text{₹ } 1,000 \times 12$ )	12,000		12,000	
Less: Exemption ( $\text{₹ } 300 \times 12 \times 2$ )	7,200	4,800	7,200	4,800
<b>Taxable Allowance</b>		<b>8,400</b>		<b>8,400</b>

## Truck Driver's Allowance

Any allowance (by whatever name called) granted to an employee working in any transport system to meet his personal expenditure during his duty performed in the course of running of such transport (from one place to another place), provided such employee is not in receipt of daily allowance.

**Treatment:** Minimum of the following shall be exempted:

- 70% of allowance.
- $\text{₹ } 10,000$  p.m.

**Tax point:** If assessee is in receipt of Daily allowance then above allowance shall be fully taxable.

## Transport Allowance

An allowance, by whatever name called, to meet the expenditure for the purpose of travelling between the place of residence and the place of duty.

**Available to:** Assessee is blind / deaf and dumb / orthopedically handicapped.

**Treatment:** Minimum of the following shall be exempted:

- Actual amount received; or



b. ` 3,200 p.m.

**Tax point:** No exemption is available to the assessee other than specified above.

#### **Allowance to Government employees outside India**

As per sec. 10(7), any allowance or perquisite allowed outside India by the Government to an Indian citizen for rendering services outside India is wholly exempt from tax.

#### **Tax point:**

1. Assessee must be -

- a) Government employee
- b) Citizen of India; and
- c) Working outside India

2. Any allowance or perquisite to such employee shall be exempted u/s 10(7)

#### **Allowance received from UNO (United Nations Organization)**

Basic salary or Allowance paid by the UNO to its employees are not taxable.

#### **Compensatory allowance under Article 222(2) of the Constitution**

It is fully exempt from tax.

#### **Allowance to judges of the High Court or the Supreme Court**

Any allowance paid to Judges of the High Court u/s 22A(2) and sumptuary allowance u/s 22C of the “High Court Judges (Conditions of Service) Act, 1954” is not taxable. Allowance to the Supreme Court Judges u/s 23B of the “Supreme Court Judges (Conditions of Service) Act, 1958” is also exempt.

#### **Salary to teacher or professor from SAARC Member States [DTAA]**

Salary including allowances and perquisites of a teacher or professor or research scholars from SAARC Member States shall not be taxable if following conditions are satisfied:

1. Such professor, teacher or research scholar is a resident of other SAARC member State (i.e., Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan & Sri Lanka) prior to visiting another member State.

**Tax point:** An individual is deemed to be a resident of a member State if he/she is resident in that member State in the fiscal year in which he visits the other member State or in the immediately preceding fiscal year.

2. Such visit is for the purposes of teaching or engaging in research or both at a university or college or similar approved institution in that other Member State.

3. The remuneration from aforesaid activities in other Member State is exempt for a period of 2 years from the date of arrival in the other member State.

**Allowance or Perquisite to member of Union Public Service Commission [Sec. 10(45)]**

Any allowance or perquisite, as may be notified by the Central Government in the Official Gazette in this behalf, paid to the Chairman or a retired Chairman or any other member or retired member of the Union Public Service Commission is exempt.

**PERQUISITE [SEC. 17(2)]**

**Meaning and Chargeability**

In common parlance, perquisite means, any casual emoluments or benefits attached to an office or position, in addition to salary or wages, which is availed by an employee. In other words, perquisites are the benefits in addition to normal salary.

As per sec. 17(2) of the Income tax Act, *Perquisite* includes -

- i. Value of rent-free accommodation provided by the employer.
- ii. Value of concession in rent in respect of accommodation provided to the assessee by his employer.
- iii. The value of any benefit or amenity granted or provided free of cost or at concessional rate to 'specified employees'.
- iv. Amount paid by an employer in respect of any obligation which otherwise would have been payable by the employee.

**Tax point:** Any obligation of the employee met by employer shall be taxable on cash basis i.e. in the year in which amount is paid by the employer.

**Example:** Employer paid employees' professional tax liability pertaining to period 2017-18 in April 2018, such perquisite shall be taxable in the previous year 2018-19.

- v. Sum payable by an employer, whether directly or through a fund other than recognised provident fund or approved superannuation fund or deposit-linked insurance fund, to effect an assurance on the life of the assessee or to effect a contract for an annuity.

**Tax point:** Such sum shall be taxable on accrual basis.

- vi. The value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee.

- vii. Any contribution in excess of ₹ 1,50,000 to an approved superannuation fund by the employer in respect of the assessee.

- viii. the value of any other fringe benefit or amenity as may be prescribed.

**Notes:**

- a) Perquisites are taxable under the head “Salaries” only if, they are:
- Allowed by an employer to his employee or *any member of his household*.
  - Resulting in the nature of personal advantage to the employee.
  - Derived by virtue of employee’s authority.
- b) Perquisite may be contractual or voluntary. In other words, it is not necessary that the benefit must have been received under an enforceable right.
- c) Perquisite may be received from the former, present or prospective employer
- d) Member of household includes:
- Spouse (whether dependent or not)
  - Parents (whether dependent or not);
    - Servants; and
    - Children and their spouse (whether dependent or not);
    - Dependents.

**\$ Specified employees [Sec. 17(2)(iii)]**

Specified employee means:

1. A director employee.

**Note:** It is immaterial -

- a) whether he is a nominee of the workers, financial institutions, etc. on the board;
- b) whether the employee is full time director or a part time; and
- c) whether he was a director throughout the previous year or not.

**Tax point:**

- A director-employee shall be treated as specified employee of that company only.

**Example:** If Manu is working with X Ltd. as director-employee and with Y Ltd. as employee only, she will be treated as specified employee only for X Ltd. and not for Y Ltd.

- Director even for a day is construed as specified employee of such company.

2. An employee who has substantial interest in the employer company.

**Substantial interest** means the employee who beneficially holds 20% or more voting power in the employer company.

**Tax point:**

- Such employee shall be treated as specified employee of that company only.
- The main criteria is beneficial ownership and not the legal ownership.
- Substantial interest must be held by the assessee individually, and not together with relative.

**Example:** Mr. Mohan holds 18% equity share of X Ltd. and his wife holds 7% equity share of the same company. In such case Mr. Mohan will not be treated as specified employee.

3. An employee whose aggregate salary from all employers together exceeds ` 50,000 p.a.

For computing the sum of ` 50,000, following are to be excluded/deducted:

- a) All non-monetary benefits;
- b) Non-taxable monetary benefits;
- c) \*Deduction u/s 16(ia), 16(ii) and 16(iii) [Discussed later in this chapter]; and
- d) Employer's contribution to Provident Fund.

**Tax point:**

- Where salary is received from two or more employers, the aggregate salary from all employers shall be considered for calculation of above ceiling. And if aggregate salary exceeds ` 50,000 p.a. the employee shall be treated as specified employee of all employers.

**Example:** Mr. Rohan is working with X & Co. and Y Ltd. His taxable monetary salary from X & Co. is ` 36,000 p.a.

and from Y Ltd. is ` 45,000 p.a. Since the aggregate salary is more than ` 50,000 p.a. Mr. Rohan will be treated as specified employee for both the employer i.e. X & Co. and Y Ltd.

- Even 'DA not forming a part of salary for retirement benefit' shall be included in salary, while determining the above limit of ` 50,000 p.a.

**Exempted Perquisites**

Following perquisites are exempted in hands of employee:

- 1. Tea or snacks:** Tea, similar non-alcoholic beverages and snacks provided during working hours.
- 2. Food:** Food provided by employer in working place.
- 3. Recreational facilities:** Recreational facilities extended to a group of employees.
- 4. Goods sold to employee at concessional rate:** Goods manufactured by employer and sold by him to his employees at concessional (not free) rates.
- 5. Conveyance facility:** Conveyance facility provided -
  - to employees for journey between office and residence and vice versa.

- to the judges of High Court and Supreme Court

**6. Training:** Amount spent on training of employees including boarding & lodging expenses for such training.

**7. Services rendered outside India:** Any perquisite allowed outside India by the Government to a citizen of India for rendering services outside India.

**8. Contribution in some specified schemes**

- Employer's contribution to a pension or deferred annuity scheme.
- Employer's contribution to staff group insurance scheme.
- Annual premium paid by the employer on personal accident policy effected by him in respect of his employee.

**9. \*Loans**

- Loan given at nil or at concessional rate of interest by the employer provided the aggregate amount of loan does not exceed ₹ 20,000.
- Interest free loan for medical treatment of the diseases specified in Rule 3A.

**10. \*Medical facility:** A provision of medical facility at office is exempt.

**Note:** However, medical allowance is fully taxable.

**11. Periodicals and journals:** Periodicals and journals required for discharge of work.

**12. Telephone, mobile phones:** Expenses for telephone, mobile phones actually incurred on behalf of employee by the employer whether by way of direct payment or reimbursement.

**13. \*Free education facility:** Free education facility to the children of employee in an institution owned or maintained by the employer provided cost of such facility does not exceed ₹ 1,000 p.m. per child.

**Note:** Such facility is not restricted to two children as in case of Children Education allowance.

**14. Computer or Laptop:** Computer or Laptop provided whether to use at office or at home (provided ownership is not transferred to the employee).

**15. \*Movable assets:** Sale or gift of any movable asset (other than car and electronic items) to employee after being used by the employer for 10 or more years.

**16. \*Leave Travel Concession:** Leave Travel Concession (LTC) subject to few conditions.

**17. Rent-free accommodation**

- Rent-free official residence provided to a Judge of a High Court or the Supreme Court.
- Rent-free furnished residence (including maintenance thereof) to Official of Parliament, a Union Minister or a Leader of opposition in Parliament.

**18. \*Accommodation:** Accommodation provided -

- on transfer of an employee in a hotel for a period not exceeding 15 days in aggregate.
- in a remote area to an employee working at a mining site or an onshore exploration site or a project execution site or a dam site or a power generation site or an offshore site.

**19. Tax on non-monetary perquisite** paid by employer on behalf of employee. With effect from A.Y. 2003-04 a new sec. 10(10CC) has been inserted which provides that income tax paid by employer on behalf of employee on income, being non-monetary perquisite, is not a taxable perquisite.

**20. Health club, Sports club** facility

**LEAVE TRAVEL CONCESSION [SEC. 10(5)]**

If an employee goes on travel (on leave) with his family and traveling cost is reimbursed by the employer, then such reimbursement is fully exempted.

**Notes**

- 1) Journey may be performed during service or after retirement.
- 2) Employer may be present or former.
- 3) Journey must be performed to any place within India.
- 4) In case, journey was performed to various places together, then exemption is limited to the extent of cost of journey from the *place of origin to the farthest point* reached, by the *shortest route*.
- 5) Employee may or may not be a citizen of India.
- 6) Stay cost is not exempt.

**Exemption:** Exemption is limited to the amount actually incurred on the travel to the extent as under:

<b>Journey performed</b>	<b>Maximum exempted fare</b>
By Air	Air economic class fare of shortest route
When the place of origin and destination is connected by rail but journey is performed by any other mode of transport	Same as above
When the place of origin and destination is not connected by rail:	
Where a recognized public transport system exists	First class or deluxe class fare, as the case may be, on such transport.
Where no recognized public transport system exists	Amount equivalent to air-conditioned 1st class rail fare, for the distance of the journey by the shortest route, as if journey had been performed by rail.

## Notes

- a) No exemption can be claimed without performing journey and incurring expenses thereon.
- b) **Block-period:** Exemption is available in respect of 2 journeys performed in a block of 4 **calendar** years commencing from 1st January 1986.

Academically, for the A.Y. 2019-20, the relevant block is Jan 2018 to Dec. 2021.

- c) **Carry-forward facility:** Where concession is not availed during the preceding block (whether on one occasion or both), then any one journey performed in the *first calendar year of the immediately succeeding block* will be additionally exempted (i.e. not counted in two journey limit)

- d) **Family:** Family here means -

- Spouse and children of the individual; and
- Parents, brothers and sisters of the individual, who are wholly or mainly dependent on him.

- e) **Restriction on number of children:** Exemption can be claimed for any number of children born on or before 30/9/1998. In addition, exemption is available only for 2 surviving children born on or after 1/10/1998.

However, children born out of multiple birth, after the first child, will be treated as one child only.

- f) **Fixed Leave travel allowance:** Fixed amount paid to employees by way of leave travel allowance shall not be exempt.

- g) The exemption u/s 10(5) is for travel cost and does not include stay cost or other cost.

### Valuation of Rent-free unfurnished accommodation (RFA) [Rule 3(1)]

Rent-free accommodation is taxable in the hands of all employees (except the Judges of High Court or Supreme Court and Official of the Parliament or Union Minister and a leader of Opposition).

Accommodation here includes fixed as well as floating structure.

Fixed Structure	A house, flat, farmhouse (or a part thereof), accommodation in hotel, motel, service apartment, a guest house etc.
Floating Structure	A caravan, mobile home, ship etc.

For the purpose of valuation, employees are divided into three categories:

- a. Employees of the Central or State Government or of any undertaking under the control of the Government;

- b. Accommodation provided by Government to an employee serving on deputation
- c. Other employees

**I) Central and State Government Employee (including military person)**

Where the accommodation is provided by the Central Government or any State Government to the employees either holding office or post in connection with the affairs of the Union or of such State, the value of perquisite in respect of such accommodation is equal to the license fee, which would have been determined by the Central or State Government in accordance with the rules framed by the Government.

**II) Accommodation provided by Government to an employee serving on deputation**

Where the accommodation is provided by the Central Government or any State Government to an employee who is serving on deputation with anybody or undertaking under the control of such Government, then the value of perquisite of such an accommodation shall be:

<b>City in which accommodation is provided</b>	<b>Value of perquisite</b>
Having population exceeding 25 lacks as per 2001 census	15% of salary for the period during which the employee occupied the said accommodation.
Having population exceeding 10 lacks but not exceeding 25 lacks as per 2001 census	10% of salary for the period during which the employee occupied the said accommodation.
Any other city	7.5% of salary for the period during which the employee occupied the said accommodation.

**III) Other Employees (residual category)**

The value of perquisite is determined as per the following table:

<b>City in which accommodation is provided</b>	<b>Accommodation is owned by the employer</b>	<b>Accommodation is not owned by the employer</b>
Having population exceeding 25 lacks as per 2001 census	15% of salary for the period during which the employee occupied the said accommodation.	Rent paid or payable by the employer or 15% of salary, whichever is lower.
Having population exceeding 10 lacks but not exceeding 25 lacks as per 2001 census	10% of salary for the period during which the employee occupied the said accommodation.	
Any other city	7.5% of salary for the period during which the employee occupied the said accommodation.	



### ILLUSTRATION

Mr. Chauhan has the following salary structure::

a) Basic Salary ` 5,000 p.m.	b) Entertainment Allowance ` 1,000 p.m.
c) Education Allowance ` 500 p.m. (he has three children)	d) DA ` 3,000 p.m.
e) Fees ` 5,000 p.a.	f) Bonus ` 10,000 p.a.
g) Professional tax of employee paid by employer	` 2,000 for the year

h) He has been provided a rent-free accommodation in Mumbai.

i) 60% of DA only forms part of retirement benefits

Compute taxable value of accommodation in the hands of Mr. Chauhan in the following cases:

i) The employer owns such accommodation.

ii) The employer hires such accommodation at a monthly rent of ` 900.

### Solution

Taxable value of rent-free accommodation for the A.Y. 2019-20

Particulars	Basis of determination	Taxable Perquisite
(i) Owned by employer	15% of Salary (Working)	` 16,830
(ii) Hired by employer	15% of Salary or Actual rent paid by employer, whichever is lower	` 10,800

**Working:** Salary for the purpose of Rent-free accommodation:

Particulars	Details	Amount (₹)	Amount (₹)
Basic Salary			60,000
Bonus			10,000
Fees			5,000
<b>Allowances</b>			
Dearness allowance	` 36,000 × 60%	21,600	
Entertainment Allowance		12,000	
Education Allowance	` 6,000 – ` 2,400	3,600	37,200
<b>Gross Taxable Salary</b>			<b>1,12,200</b>

### ILLUSTRATION

In above illustration, how shall answer differ if the property is situated in a city where population is only 14,60,000.

**Solution**

Taxable value of rent free accommodation for the A. Y.2019-20

Particulars	Basis of determination	Taxable value of Perquisite
Owned by employer	10% of Salary (as per the above working)	₹ 11,220
Hired by employer	15% of Salary or Actual rent paid by employer, whichever is lower	₹ 10,800

**ILLUSTRATION**

Miss Stuti has the following salary structure: ₹

- a) Basic salary 15,000 p.m.
- b) Dearness Allowance 5,000 p.m. (not forming part of retirement benefit)
- c) Hostel Allowance 1,000 p.m. (does not have any child)
- d) Tiffin Allowance 500 p.m.
- e) Transport Allowance 200 p.m.
- f) Bonus 20,000 p.a.
- g) Commission 15,000 p.a.
- h) Free refreshment in office worth 5,000 p.a.
- i) Mobile phone facility by employer 900 p.m.
- j) Computer facility worth 10,000 p.a.

She has been provided a Rent-free Accommodation (owned by employer) in Kolkata. The house was allotted to her with effect from 1/5/2018 but she could occupy the same only from 1/6/2018. Find her gross taxable salary.

**Solution**

Computation of gross taxable salary of Miss Stuti for the A. Y. 2019-20

Particulars	Details	Amount (₹)	Amount (₹)
Basic Salary			1,80,000
Bonus			20,000
Commission			15,000
<b>Allowances:</b>			
Dearness Allowance		60,000	
Hostel Allowance (Fully taxable as she has no child)		12,000	
Tiffin Allowance		6,000	

Transport Allowance		2400	80,400
<b>Perquisite u/s 17(2):</b>			
Free Refreshment (not taxable)		Nil	
Mobile or telephone facility		Nil	
Computer facility		Nil	
Rent Free Accommodation	Working	29,425	29,425
<b>Gross Salary</b>			<b>3,24,825</b>

**Working :Salary for the purpose of rent-free accommodation**

Basic Salary	1,80,000
Bonus	20,000
Commission	15,000
<u>Allowances</u>	
Dearness allowance	Nil
Hostel Allowance	12,000
Tiffin Allowance	6,000
Transport Allowance	2,400
Total	2,35,400
Value of Rent-Free Accommodation (being 15% × ` 2,35,400 × 10/12)	29,425

## PROVIDENT FUND

Provident fund scheme is a saving device in the hands of salaried class. It is a retirement benefit scheme. Under this scheme, a stipulated sum is regularly deducted from the salary of the employee as his contribution towards the fund. The employer also, generally, contributes a similar amount out of his pocket to the fund. The employer's and employee's contribution are together invested in such fund. Interest earned thereon is also credited to the fund of the employee. Thus, provident fund scheme is a great media to initiate and mobilize small savings to a large scale. On termination of service or retirement, employee receives the whole accumulated fund, subject to certain conditions. Hence, provident fund has four components i.e. Employer's contribution; Employee's contribution; Interest on employer's contribution; and Interest on employee's contribution.

Provident fund is of four types, viz:

**a) Statutory Provident Fund (SPF):** Statutory provident fund is set up under the provisions of the Provident Funds Act, 1925. Government and Semi-Government organizations, local authorities, railways, Universities and recognized educational institutions maintain Statutory Provident Fund.

**b) Recognized Provident Fund (RPF):** The provident fund scheme is framed under the Employee's Provident Fund and Miscellaneous Provisions Act, 1952 (hereinafter referred as PF Act). The PF Act covers any establishment employing 20 or more persons. However, any establishment employing less than 20 persons can also join the scheme provided employer and employee both agree to do so. Further, if an employer creates his own scheme for provident fund then he can do so subject to recognition from the Commissioner of Income tax.

**c) Unrecognized Provident Fund (URPF):** If a provident fund scheme is created by an employer, which is not recognized by the Commissioner of Income tax, then such fund is known as Unrecognized provident fund.

**d) Public Provident Fund (PPF):** The Central Government has established a fund for the benefit of public to mobilize personal savings. Any member of the public, whether salaried or self-employed, can contribute to the fund by opening a provident fund account at any branch of the State Bank of India or its subsidiaries or other nationalised bank. Even a salaried employee can simultaneously become a member of employee's provident fund (whether statutory, recognised or unrecognized) and public provident fund. Any amount in multiple of ` 5 (subject to minimum of ` 500 and maximum of ` 1,50,000 p.a.) may be deposited in this account. Interest is credited every year but payable only at the time of maturity. Interest earned on this fund is exempt from tax u/s 10(11).

### ***ILLUSTRATION***

Mr. X has the following salary structure –

Basic pay ` 10,000 p.m. Commission (fixed) ` 2,000

DA ` 1,000 p.m. Entertainment allowance ` 2,000 p.m.

X contributes ` 20,000 to provident fund. Employer also makes a matching contribution. Compute gross salary of if –

- a) Mr. X is a Government employee and such provident fund is a statutory provident fund.
- b) Mr. X is an employee of Y Ltd. and such fund is a recognized fund.
- c) Mr. X is an employee of Z Ltd. and such fund is an unrecognized fund.

## Solution

Computation of taxable salary of Mr. X for the A.Y. 2019-20

Particulars	Case A		Case B		Case C	
	Details	Amount	Details	Amount	Details	Amount
Basic		1,20,000		1,20,000		1,20,000
Commission		2,000		2,000		2,000
<u>Allowances</u>						
Dearness allowance	12,000		12,000		12,000	
Entertainment allowance	24,000	36,000	24,000	36,000	24,000	36,000
contribution to PF	20,000		20,000		20,000	
Less: Exempted	20,000	Nil	15,840	4,160	20,000	Nil
<b>Gross Salary</b>		<b>1,58,000</b>		<b>1,62,160</b>		<b>1,58,000</b>

## Notes

1. Contribution to statutory and unrecognised provident fund is fully exempted.
2. Contribution to recognised provident fund is exempt upto 12% of salary. Salary for such purpose

–

Particulars	Amount (₹)
Basic	1,20,000
Commission (as fixed)	Nil
Dearness allowance	12,000
Total	1,32,000

## ILLUSTRATION

Mr. Sharma has been appointed as an accountant of ABC Ltd as on 1/4/2016, since then he is working with the same company. The salary structure and increment details are as under:

Basic ` 5000 - 1000 - 8000 -1500 - 14000

D.A. ` 3000 – 500 – 5000 – 1000 - 10000

He and his employer contribute to URPF 14% of basic and DA.

Every year 9% interest is credited to such fund. As on 1/4/2018, the fund gets recognition.

Hence, the accumulated balance in URPF was transferred to RPF. Comment on tax treatment of such transferred balance.

## Solution

Statement showing treatment of transferred balance :

Year	Employer's contribution to fund	Exempted amount considering the fund as RPF	Difference
2016-2017	14% of (60,000 + 36,000) i.e. ₹ 13,440	12% of ₹ 96,000 i.e. ₹ 11,520	₹ 1,920
2017-2018	14% of (72,000 + 42,000) i.e. ₹ 15,960	12% of ₹ 1,14,000 i.e. ₹ 13,680	₹ 2,280
<b>Total</b>			<b>₹ 4,200</b>

### Deduction from Gross Salary [Sec. 16]

#### STANDARD DEDUCTION [SEC. 16(ia)]

Lower of the following shall be allowed as standard deduction to all employee:

- ₹ 40,000
- Amount of gross salary

#### ENTERTAINMENT ALLOWANCE [SEC. 16 (ii)]

Entertainment allowance is initially included in taxable allowances as fully taxable. Thereafter, a deduction is allowed under this section from *gross taxable salary*. However, deduction u/s 16(ii) shall be available to the Government employee only.

Deduction for Entertainment allowance being minimum of the following:

- Actual Entertainment Allowance
- ₹ 5,000/-
- 20% of **Basic Salary**.

### ILLUSTRATION

Compute taxable Entertainment allowance & net salary of Sri Hanuman Prasad from the following data:

Basic salary ₹ 8,000 p.m. D.A. ₹ 2,000 p.m. Taxable perquisite ₹ 35,000, Entertainment Allowance ₹ 4,000 p.m. Out of such allowance ₹ 20,000 is expended and balance amount is saved. Assuming he is:

- Government employee
- Non-Government employee.

## Solution

Computation of taxable income of Sri Hanuman Prasad for the A. Y. 2019-20

Particulars	Government Employee		Non-Government Employee	
	Details (₹)	Amount (₹)	Details (₹)	Amount (₹)
Basic Salary		96,000		96,000
Dearness Allowance		24,000		24,000
Entertainment Allowance		48,000		48,000
Taxable perquisite		35,000		35,000
<b>Gross Taxable Salary</b>		<b>2,03,000</b>		<b>2,03,000</b>
Less: <u>Deduction u/s</u>				
16(ia) Standard Deduction	40,000		40,000	
16(ii) Entertainment allowance#	5,000	45,000	Nil	40,000
<b>Net Taxable Salary</b>		<b>1,58,000</b>		<b>1,63,000</b>

Entertainment Allowance is exempted to the extent of minimum of the following :

- a. Actual Entertainment Allowance ` 48,000
- b. 20% of Basic Salary ` 19,200
- c. Statutory amount ` 5,000

### TAX ON EMPLOYMENT OR PROFESSIONAL TAX [SEC. 16(iii)]

Tax on employment, profession, trade, etc. levied by a State under Article 276 of the Constitution will be allowed as deduction on cash basis, whether paid by employee or by employer (on behalf of employee) from gross taxable salary.

**Note:** If employer (on behalf of employee) pays Professional tax then:

- a. Firstly, it is to be included as taxable perquisite; and
- b. Further, it is allowed as deduction u/s 16(iii).

### ILLUSTRATION 35

Mr. Rohit a non-Government employee has the following salary details :

- a. Basic Salary ` 5,000 p.m. b. D.A. ` 2,000 p.m.
- c. Entertainment Allowance ` 300 p.m. d. Professional tax paid by employee ` 600
- e. LIC Premium paid by employer ` 3,600 f. Income tax paid by employee ` 2,000
- g. Professional tax paid by employer on behalf of employee ` 1,600

Find his taxable salary.

## Solution

Computation of taxable salary Mr. Rohit for the A.Y.2019-20

Particulars	Details (₹)	Amount (₹)
Basic Salary		60,000
<u>Allowances</u>		
Dearness Allowance	24,000	
Entertainment Allowance	3,600	27,600
<u>Taxable perquisite</u>		
Professional tax paid by employer	1,600	
LIC Premium paid by employer	3,600	5,200
<b>Gross Taxable Salary</b>		92,800
<u>Less: Deduction u/s</u>		
16(ia) Standard Deduction	40,000	
16(ii) Entertainment allowance (Assessee is a Non-government employee)	Nil	
16(iii) Professional Tax (₹ 1,600 + ₹ 600)	2200	42,200
<b>Taxable Salary</b>	<b>50,600</b>	

## ILLUSTRATION

Mr. Das retired on 31/3/2019. At the time of retirement, 18 months leave was lying to the credit of his account. He received leave encashment equivalent to 18 months Basic salary ₹ 1,26,000. His employer allows him 1½ months leave for every completed year of service. During his tenure, he availed of 12 months leave. At the time of retirement, he also gets D.A. ₹ 3,000. His last increment of ₹ 1,000 in basic was on 1/4/2018. Find taxable leave encashment.

## Solution

### Working

**1. Calculation of completed year of service:** Employee has received 18 months leave encashment on termination of service as well he had enjoyed leave of 12 months during his tenure. That means he had received a leave benefit of 30 months. Since leave allowed by employer is 1½ months for every completed year of service, this signifies that Mr. Das had completed 20 years (being 30/1½) of service.

**2. Salary here means, Basic + DA + Commission, being last 10 months average from the date of retirement. There is no increment in last 10 months (last increment was on 1/4/2018) and there is no commission, hence Av. Salary = ₹ 7,000 (i.e. ₹ 1,26,000/18) + ₹ 3,000 = ₹ 10,000 p.m.**



### Computation of taxable leave encashment of Mr. Das for the A.Y. 2019-20

Particulars	Details (₹)	Amount (₹)
Leave Encashment received		1,26,000
Less: Minimum of the following is exempt u/s 10(10AA)(ii):		
(a) Actual amount received	1,26,000	
(b) Statutory Amount	3,00,000	
(c) 10 months × Av. Salary p.m. (10 × 10,000)	1,00,000	
(d) {1 × completed year of service - Leave taken} × Avg. salary p.m. [ {1 × 20 - 12} × ₹ 10,000]	80,000	80,000
<b>Taxable Leave Encashment</b>		<b>46,000</b>

### ILLUSTRATION

Mr. Amit has retired from his job on 31/3/2018. From 1/4/2018, he was entitled to a pension of ₹ 3,000 p.m. On 1/8/2018, he got 80% of his pension commuted and received ₹ 1,20,000. Compute taxable pension if he is:

**Case a)** Government employee;

**Case b)** Non-Government employee & not receiving gratuity

**Case c)** Non-Government employee (receiving gratuity, but not covered by the Payment of Gratuity Act)

### Solution

Computation of taxable pension of Mr. Amit for the A.Y. 2019-20

Particulars	Case a		Case b		Case c	
	Details (₹)	Amount (₹)	Details (₹)	Amount (₹)	Details (₹)	Amount (₹)
<b>Uncommuted Pension</b>						
- 1/4/2018 to 31/7/2018 (₹ 3,000 × 4)	12,000		12,000		12,000	
- 1/8/2018 to 31/3/2019 (₹ 600 × 8)	4,800	16,800	4,800	16,800	4,800	16,800
<b>Commuted Pension</b>	1,20,000		1,20,000		1,20,000	
Fully exempted u/s 10(10A)(i)	1,20,000	Nil				
Exempted u/s 10(10A)(ii) (½ of ₹ 1,50,000#)			75,000	45,000		
Exempted u/s 10(10A)(ii) (1/3 of ₹ 1,50,000#)					50,000	70,000
<b>Taxable Pension</b>		<b>16,800</b>		<b>61,800</b>		<b>86,800</b>

### ILLUSTRATION

Mr. Mugal joined Star Ltd. on 1/4/2018. Details regarding his salary are as follows:

Particulars	Amount (₹)
Basic	5,000 p.m.
Dearness Allowance	2,000 p.m. (50% considered for retirement benefit)
Education Allowance	1,000 p.m. (he has 1 son and 3 daughters)
Hostel Allowance	2,000 p.m. (none of the children is sent to hostel)
Medical Allowance	1,000 p.m. (total medical expenditure incurred ₹ 3,000)
Transport Allowance	1,800 p.m. (being used for office to residence & vice versa)
Servant Allowance	1,000 p.m.
City compensatory Allowance	2,000 p.m.
Entertainment Allowance	1,000 p.m.
Assistants Allowance	3,000 p.m. (paid to assistant ₹ 2,000 p.m.)
Professional Development Allowance	2,000 p.m. (actual expenses for the purpose ₹ 8,000 p.m.)
Bonus	24,000 p.a.
Commission	9,000 p.a.
Fees	5,000 p.a.

Compute his gross taxable salary for the assessment year 2019-20.

### Solution

Computation of gross taxable salary of Mr. Mugal for the A.Y.2019-20

Particulars	Details (₹)	Amount (₹)	Amount (₹)
Basic Salary			60,000
Bonus			24,000
Commission			9,000
Fees			5,000
Allowances			
Dearness Allowance		24,000	
Education Allowance	12,000		
Less: Exemption (₹ 100 × 2 × 12)	2,400	9,600	
Hostel Allowance	24,000		
Less: Exemption (₹ 300 × 2 × 12)	7,200	16,800	
Medical Allowance		12,000	
Transport Allowance	21,600		

Less: Exemption	Nil	21,600	
Servant Allowance		12,000	
City Compensatory allowance		24,000	
Entertainment Allowance		12,000	
Assistance Allowance	36,000		
Less: Exemption (Being actual expenditure)	24,000	12,000	
Professional development allowance	24,000		
Less: Exemption (Actual expenditure max. of amount received)	24,000	Nil	1,44,000
<b>Gross Taxable Salary</b>			<b>2,42,000</b>

### Illustration

Rasheed aged 48 years is an accountant and employed by GLF Ltd. He gets Rs. 100000 per month as salary and Rs. 100000 per annum as bonus. Besides, GLF Ltd provides the following.

1. Transport allowance: 1600 per month
2. Medical facility in a hospital which is owned by GLF. Cost for providing this facility to Rasheed Rs. 30000
3. Medical facility in a government hospital Rs. 38000.
4. Medical facility in a private hospital (same hospital is recommended by the government for the medical treatment of government employees.) Rs. 18000
5. Medical facility (rule 3A) in a hospital approved by the chief commissioner: Rs. 63000
6. Medi claim insurance premium paid by GLF Ltd for Rasheed and his family Rs. 25000
7. Reimbursement by GLF Ltd. Of other medical expenditure :Rs. 18000.

You are required to calculate his salary income for the AY 2018-19 and 2019 20.

### Solution

Income of Rasheed from salary can be calculated as follows:

	AY 2018-19	AY 2019-20
Basic salary	1200000	1200000
Bonus	100000	100000
Transport allowance	Nil	19200
Medical facility in GLF Ltd's hospital	Nil	Nil
Medical facility in government hospital	Nil	Nil
Medical facility in private hospital	Nil	Nil
Medical facility (Rule 3A)	Nil	Nil
Medi-claim insurance premium paid by GLF Ltd	Nil	Nil
Reimbursement of other medical expenditure (reimbursement up to Rs. 15000 is not chargeable to tax for the assessment year 2018-19)	3000	18000
Gross salary	1303000	1337200
Less: standard deduction us 16(ia)	Nil	Nil
Income under the head salaries	1303000	1297200

### Illustration

Miss nithya is a govt. employee and she is drawing a monthly salary of Rs. 8000. She is provided with a rent free unfurnished accommodation for which the government has fixed a monthly rent of Rs. 1000. She pays a monthly rent of Rs. 200 to the government. Calculate her gross salary.

#### Solution:

Salary @ rs. 80000 p.m		96000
Value of perquisite: Rent free-unfurnished accommodation:		
Rent fixed by govt. @ Rs. 1000pm.	12000	
Less rent paid by the employee (200x12)	<u>2400</u>	<u>9600</u>
		105600

### Illustration

Mr. Jamal is employed in a town (having a population of 13 lakh). He draws a salary of Rs. 8000 pm. DA Rs. 2000pm (40% enters into retirement benefits), bonus Rs. 8000 p.a Commission Rs. 4500 p.a. Entertainment allowance Rs. 500 p.m. FRV of rent free house provided by the employer Rs. 40000 p.a .value of the furniture provided Rs 20000. Calculate this income from salary for the assessment year 2019-20.

#### Solution

Computation of income from salary	
Salary	96000
DA	24000
Bonus	8000
Commission	4500
Entertainment allowance	6000
Value of rent free furnished house	<u>14410</u>
	152910
Less: Deduction as per Section 16	
Standard deduction	<u>40000</u>
Income from salary	<u>112910</u>

#### Computation of value of rent free furnished house

Salary (96000+40% of 24000 (DA) + 8000+4500+6000=	124100
10% of salary	12410
Add 10% of cost of furniture	<u>2000</u>
	<u>14410</u>

### Illustration

The following are the particulars of income of Mr.Baburaj for the previous year ended 31<sup>st</sup> March 2019. He is employed by an individual.

1. Salary Rs.9000 p.m
2. Bonus equal to 2 months salary

3. Dog allowance Rs. 150 p.m
4. Special allowances Rs. 120 pm
5. Employee's contribution to RPF @ 15% of salary.
6. Employers contribution to the fund @ 15% of the salary.
7. Interest credited to the provident fund @ 9.5% p.a is Rs. 5600
8. He is provided with free lunch in office. The cost per meal is Rs. 30.
9. The employer has given him a small car which he uses for his personal and office use. He meets the expenses of the car which is used for personal purposes.

Compute his income from salary for the assessment year 2019-20.

### **Solution**

#### **Computation of income from salary of Mr. Krishnan for the assessment year 2019-20**

Salary	108000
Bonus	18000
Dog allowance	1800
Special allowance	1440
Employer's contribution to RPF in excess of 12% of salary	3240
Lunch (cost does not exceed Rs. 50 per meal )	Exempted
Car @600 p.m	7200
<b>Gross salary</b>	<b>139680</b>
Less deduction standard deduction	40000
Income from salary	99680

### **Illustration**

Mr. Rajiv furnished the following particulars of his income for the year 2018-19.

Salary	rs. 15000pm
DA	Rs. 1250pm
Entertainment allowance	Rs. 1000 pm
Employer's and Employees contribution to RPF	Rs. 24000 each
Interest on PF AT 9.5% P.a	Rs. 19000
City compensatory allowance	Rs. 200 pm
Medical allowance	Rs. 10000

He has been provided with an unfurnished accommodation (population less than 10 lakhs) for which the employee paid Rs. 500 p.m the house is owned by the employer, fair rental value is Rs. 30000 p.a. a sweeper at Rs. 200 pm and a servant at Rs. 750. For the assessment year 2019-20.

**Solution**

## Computation of taxable income from salary

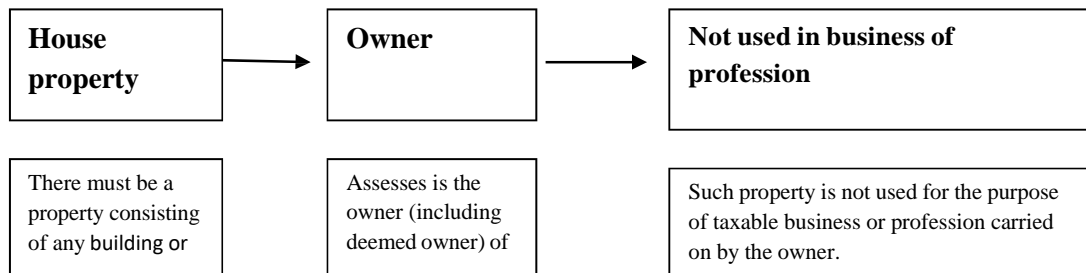
Salary		180000
DA		18000
Entertainment allowance		12000
Employer's contribution to RPF in excess of 12%		2400
City compensatory allowance		2400
Medical allowance		10000
Sweeper		2400
Servant		9000
Concession in rent		
Value	15330	
Less rent paid by the employee	6000	9330
<b>Gross salary</b>		<b>245530</b>
Less standard deduction		40000
<b>Taxable salary</b>		<b>205530</b>

# MODULE III

## INCOME FROM HOUSE PROPERTY

As per sec. 22, the annual value of property consisting of any building or land appurtenant thereto of which assessee is the owner, other than such portion of such property as he may occupy for the purposes of any business or profession carried on by him shall be chargeable to income tax under the head “ Income from house property.”

It is an exceptional feature of this head that rather than actual income from house property, earning capacity of house property is taxable. As stated u/s 22 that “annual value” of the property is taxable rather than actual income of the property.



### Condition 1: Building or land appurtenant thereto

The term ‘house property’ is not defined in Income tax Act. However, various judicial interpretation have construed the term house property as -

- any land surrounded by wall having roof or not; and
- any land appurtenant to a building.

#### Notes

- a) Building includes an enclosure of bricks, stone work or even mud walls
- b) Building includes residential as well as commercial houses.
- c) Vacant land is not a house property. Hence, income from letting of vacant land is not taxable under this head but taxed as business income or as income from other sources.
- d) Roof is not necessary for a non-residential house property. A large stadium or a open air swimming pool is also considered as building
- e) It should be a permanent structure meant for a useful purpose.
- f) If a building consists of several flats, then each flat is considered as a separate house property.

- g) An incomplete, a ruined or demolished house cannot be termed as house property.
- h) Land appurtenant to a building includes car parking area, approach roads, backyards, courtyards, etc. attached to such building.

### **Condition 2: Owner**

Annual value of a property is assessed to tax only in the hands of the owner even if he is not in receipt of any income. Any person other than the owner, even though he is in receipt of rent shall not be liable to tax under this head. That is why, income from sub-letting is not taxable under this head but under the head 'Income from other sources'. E.g. Mr. X being a tenant of a house property acquired it at a monthly rent of ₹ 10,000 from Mr. Y (owner of such house property). Mr. X sublets the property to Mr. Z for a monthly rent of ₹ 12,000. Income from subletting being ₹ 2,000 p.m. is taxable as business income or as income from other sources.

Owner includes legal owner, beneficial owner and deemed owner.

**Legal owner:** Legal owner means a person who has the legal title of the property as per the Transfer of Property Act, Registration Act, etc.

**Beneficial owner:** For income tax purpose it is not necessary that the property must be registered in the name of the assessee. If the assessee is enjoying the property as an owner to full extent he will be treated as a beneficial owner of such property and will be charged under the head 'Income from house property'.

### **Fictional owner or Deemed owner [Sec. 27]**

U/s 27, in the following cases, a person shall be treated as deemed owner of the property and liable to tax (in such case legal owner or beneficial owner shall not be further liable to tax)

#### **1. Transfer to spouse or minor child [Sec. 27(i)]:** When an individual transfers a house property to

-

- his or her spouse (not being a transfer in connection with an agreement to live apart); or
- a minor child (not being a married daughter)

- without adequate consideration, then transferor shall be treated as deemed owner of such property.

**E.g.:** Mr. X transfers his house property worth ₹ 5,00,000 to Mrs. X out of love and affection. In such case, though Mrs. X is the legal owner but Mr. X will be liable to tax as deemed owner of such property.

**Note:** In case of transfer to spouse, marriage should subsist on both the days i.e., on the day of transfer as well as on the day when income arises.



**Tax point:**

- Transferee must be spouse or minor child other than married daughter.
  - Transfer must be without adequate consideration.
  - Transferred property must be a house property. E.g. Mr. X transfers cash of ₹ 5,00,000 to Mrs. X and Mrs. X purchases a house property from such cash, then such transfer of cash and subsequent purchase of property shall not attract provision of sec. 27(i). However, the income from such property shall be clubbed in the hands of Mr. X as per the provision of sec. 64(1)(iv) [For detail refer chapter Clubbing of Income].
- 2. The holder of an impartible estate [Sec. 27(ii)]:** The holder of an impartible estate (property which is not legally divisible) is treated as deemed owner of house property. Impartible estate is an estate to which the assessee has succeeded by grant or covenant.
- 3. Property held by a member of a company, society or any other association [Sec. 27(iii)]:** Property held by a member of a company, co-operative society or other association of persons to whom a building or a part thereof is allotted or leased under House Building Scheme of the company or association, is treated as deemed owner of that building or a part thereof.

**Taxpoint:**

- Assessee is the member of a company, co-operative society or other AOP.
  - He has been allotted or leased a building on account of such membership.
  - Though he is not the legal owner of such property, still he will be liable to tax.
- 4. A person who acquired a property u/s 53A of the Transfer of Property Act [Sec. 27(iiiia)]:** A person who is allowed to take or retain possession of any building (or part thereof) in part performance of a contract u/s 53A of the Transfer of Property Act, 1882, is deemed as the owner of that building (or part thereof).

**Taxpoint:**

- Assessee has taken the possession of the property.
  - He has partly performed or promised to perform the contract i.e., he has paid (or is ready to pay) a part of the consideration.
  - The contract must be in writing. Though sale-deed might not be executed in favour of the buyer, still certain other document like 'power of attorney' or 'agreement to sell' has been executed.
- 5. Lessee of a building u/s 269UA(f) [Sec. 27(iiiib)]:** A person who acquires any right u/s 269UA(f) in or with respect to any building or part thereof, by way of lease agreement for a period not less than 12 years is deemed as the owner of that building (or part thereof).

## **Notes**

- a) Lease period should not be less than 12 years [as per sec. 269UA(f)] including extension period.
- b) Above provision does not include any right by way of lease from month to month or for a period not exceeding 1 year.

**E.g.:** X lets out a property to Miss Y on a lease of 9 years. However, Miss Y has a right to renew the lease for further period of 3 years. In such case, Miss Y shall be deemed as an owner of the property u/s 27. However, if such right of renewal of lease (for 3 years) is subject to condition that at each occasion it will be renewed for a period of 11 months, then X will be owner of the property and liable to tax u/s 22.

### **Condition 3: Property is used for business or profession carried on by the assessee**

When a person carries on business or profession in his own house property, annual value thereof is not taxable u/s 22 provided income of such business is chargeable to tax.

#### **Incidences thereof**

- Letting out to employees: If an assessee lets out the property to his employee, where such letting out supports smooth flow of his business, then such letting out shall be deemed to be incidental to business and such rent shall be chargeable under the head “Profits & gains of business or profession”.
- Letting out to Government Agencies: Where an assessee let out his property to any Government agency for locating branch of a nationalized bank, police station, post office, excise office, railway staff quarters, etc. for the purpose of running the business of assessee more efficiently, such letting out shall be deemed to be incidental to business and such rent shall be chargeable under the head “Profits & gains of business or profession”.
- Letting out to ancillary units: Where an assessee lets out its property to ancillary units, which manufactures components required by the assessee. Income from such letting out shall be taxable under the head “Profits & gains of business or profession”.

## **SOME SPECIAL CASES**

### **Foreign property**

If house property is situated abroad, then annual value of such property shall be taxable as:

Assessee	Condition for taxability
Ordinarily resident	Always taxable
Not ordinarily resident or Non resident	Income must be received in India

**Note:** The annual value of such property would be computed as if the property is situated in India.

### Disputed ownership

Merely, due to dispute regarding the title of property, assessment cannot be postponed. In such case, person who is in receipt of income or who enjoys the possession of the property is assessable to tax.

### Composite rent

Together with rent of the building, if the owner gets charges for other services or rent of other assets provided in the building (e.g. furniture, machinery, etc.), amount so received is termed as 'composite rent'.

Composite Rent = Rent for building + Rent for assets / Charges for various services

### Tax treatment of composite rent is as follows:

● **Rent including charges for amenities or services like garden facility, food, lighting, etc. or other separable assets (like machinery, plant, furniture):** If the owner of house property gets composite rent for both property as well as for services rendered or other separable asset, such composite rent shall be treated as under:

Particulars	Taxable under the head
Sum received for the use of building.	'Income from house property'.
Sum received for other amenities or other separable assets.	'Profits & gains of business or profession'; or 'Income from other sources'

However, if segregation of composite rent is not possible, then the whole amount will be taxed either under the head 'Profits & gains of business or profession' or 'Income from other sources'.

Tax point: Rent from paying guest is, generally, taxable under the head 'Income from other sources'.

● **Letting of building with other inseparable assets (like machinery, plant, furniture):** If letting of only building is not possible or not acceptable to the other party, then sum received as rent from the properties is chargeable as business income or income from other sources even if the composite rent is segregable. E.g., letting out of hotel rooms, auditoriums, etc.

### **Co-ownership [Sec. 26]**

If two or more persons own a house property jointly, then they are known as co-owners. If individual share of each co-owner is definite and ascertainable then the share of each such person shall be taxable as his income from house property.

#### **Tax treatment**

1. Share of each co-owner in the income from the property as computed in accordance with sec. 22 to 25 shall be included in his total income.
2. Where the house property is owned by co-owners and is occupied by each of the co-owner then all of them can claim benefit u/s 23(2)(a) and interest on loan shall be allowed to all the co-owners to the extent of ` 30,000/ 2,00,000 as the case may be.

**Note:** Provision of Sec. 26 is mandatory and not optional.

#### **Partner's property used by the firm**

The business carried on by the firm should be regarded as carried on by all the partners. Thus, annual letting value of a property belonging to the assessee which is in occupation of the firm in which assessee is the partner, is not includible in income of the assessee-partner u/s 22

#### **Property held as stock-in-trade [Sec. 23(5)]**

Where house property is held as stock-in-trade & not let out during any part of the previous year, then annual value of such property shall be computed as under:

<b>Period</b>	<b>Annual Value</b>
Up to 1 year from the end of the financial year in which the certificate of completion of construction of the property is obtained from the competent authority	Annual value of such property shall be taken to be nil.
After the completion of aforesaid period	Annual value of such property shall be computed as per other provisions.

#### **Doctrine of mutuality**

Sec. 22 levies tax on annual value of house-property and not on actual income from house property. In case of a club, which provides recreational facilities exclusively to its member and their guest and not to any non-members, it is considered as a non-profit seeking person and run on no-profit no-loss basis. Such club is running on the principle of mutuality and its members are not entitled to any share of profit. In the case of such a mutual concern, not only the surplus of the organisation but also the annual value of the club house shall be exempted from tax.

## EXEMPTED PROPERTIES

Income from the following house properties are exempted from tax:

1. Any one palace or part thereof of an ex-ruler, provided the same is not let out [Sec. 10(19A)].

**Taxpoint:** If the ex-ruler has a house property and the part of which is self-occupied and remaining let out then only the self occupied part of the house property shall be exempted.

2. House property of a local authority [Sec. 10(20)].
3. House property of an approved scientific research association [Sec. 10(21)].
4. House property of an educational institution [Sec. 10(23C)].
5. House property of a hospital [Sec. 10(23C)].
6. House property of a person being resident of Ladakh [Sec. 10(26A)]
7. House property of a political party [Sec. 13A]
8. House property of a trade union [Sec. 10(24)]
9. A farm house [Sec. 10(1)]
10. House property held for charitable purpose [Sec. 11]
11. House property used for own business or profession [Sec. 22].

## LET OUT PROPERTY [SEC. 23(1)]

### Computation at a glance

Computation of Income from house property of ..... for the Assessment Year .....

Particulars	Details	Amount
Gross Annual Value (GAV)		*****
Less: Municipal tax		*****
Net Annual Value (NAV)		*****
Less: Deductions u/s		
24(a) Standard deduction [30% of NAV]	****	
24(b) Interest on borrowed capital	****	****
<b>Income from house property</b>		****

### **Gross Annual Value (GAV)**

Normally, income tax is charged on income, but under the head 'Income from house property', tax is not charged on the rent earned from house property but on the inherent earning capacity of the house property. Such earning capacity is termed as Annual Value. Annual value is determined considering the following factors:

#### **A) Actual Rent Receivable [ARR]**

Any sum receivable as rent of the house property for the previous year is an evidence for determining the earning capacity of the building. Such actual rent receivable is to be computed on accrual basis. However, where tenant pays rent, which is influenced by benefits provided by the owner of the property, such rent must be disintegrated to determine actual rent i.e. De-facto rent of the property.

De facto rent = ARR – Cost of amenities.

**Taxpoint:** While computing actual rent receivable, outstanding rent shall be considered but advance rent received during the financial year is not to be considered.

#### **B) Gross Municipal Value**

It means the annual value of the property decided by municipality on which they charge municipal tax. Such valuation may also be taken as evidence of earning capacity of a property.

In metro cities (i.e. Chennai, Delhi, Kolkata, Mumbai), municipal authorities charge tax on Net Municipal Value after giving a deduction for repairs (being 10% of Gross Municipal value) and an allowance for service taxes (like sewerage tax, water tax etc. as a % of Net Municipal value). Hence, the relation between Gross Municipal Value and Net Municipal Value can be concluded as under –

In metro cities	$NMV = GMV - 10\% \text{ of } GMV - \text{Sewerage/Water Tax etc. (as a \% of NMV)}$
In non-metro cities	$GMV = NMV$

#### **C) Fair or Notional rent of the property**

Fair or notional rent of a property means rent fetched by a similar property in the same or similar locality. Though two properties might not be exactly similar still it is an indicator of rent reasonably expected from the property. An inflated or deflated rent due to emergency, relationship and such other conditions need to be adjusted to determine fair rent.

For instance, a property was let out to a friend for a monthly rent of ₹ 2,000 which might be let out to another person at the rate of ₹ 2,500 p.m. In such case, fair rent of the property shall be ₹ 2,500 p.m.

#### **D) Standard rent under the Rent Control Act**

Standard rent is the maximum rent, which a person can legally recover from his tenant under the Rent Control Act prevailing in the State in which the property is situated. A landlord cannot reasonably expect to receive from a tenant any amount more than Standard Rent. Accordingly, it can be concluded that if the property is covered by the Rent Control Act then Reasonable Expected Rent (RER) cannot exceed Standard Rent.

#### **Computation of Gross Annual Value**

**Step 1:** Calculate reasonable expected rent (RER) of the property being higher of the following:

- a) Gross Municipal Value.
- b) Fair Rent of the property.

**Note:** RER cannot exceed Standard Rent.

\* Reasonable Expected Rent (RER) is also known as Annual Letting Value (ALV).

**Step 2:** Calculate Actual Rent Received or Receivable (ARR) for the year less current year unrealised rent (UR) subject to certain conditions#.

#Unrealised Rent [Rule 4]: Unrealised Rent of current year shall be deducted in full from Actual Rent Receivable, provided the following conditions are satisfied:

- i) The tenancy is bona fide;
- ii) The defaulting tenant has vacated the property or steps have been taken to compel him to vacate the property;
- iii) The defaulting tenant is not in occupation of any other property of the assessee;
- iv) The assessee has taken all reasonable steps to institute legal proceeding for the recovery of the unpaid rent or has satisfied the Assessing Officer that legal proceedings would be worthless.

**Step 3:** Compare the values calculated in step 1 and step 2 and take the higher one.

**Step 4:** Where there is vacancy and owing to such vacancy the 'ARR – UR' is less than the RER, then 'ARR - UR' computed in step 2 will be treated as GAV.

**Taxpoint:** Reasonable Expected Rent cannot exceed Standard Rent but can be lower than Standard Rent

### **Computation of Gross Annual Value**

**Step 1:** Calculate reasonable expected rent (RER) of the property being higher of the following:

- a) Gross Municipal Value.
- b) Fair Rent of the property.

**Note:** RER cannot exceed Standard Rent.

\* Reasonable Expected Rent (RER) is also known as Annual Letting Value (ALV).

**Step 2:** Calculate Actual Rent Received or Receivable (ARR) for the year less current year unrealised rent (UR) subject to certain conditions#.

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- i) The tenancy is bona fide;
- ii) The defaulting tenant has vacated the property or steps have been taken to compel him to vacate the property;
- iii) The defaulting tenant is not in occupation of any other property of the assessee;
- iv) The assessee has taken all reasonable steps to institute legal proceeding for the recovery of the unpaid rent or has satisfied the Assessing Officer that legal proceedings would be worthless.

**Step 3:** Compare the values calculated in step 1 and step 2 and take the higher one.

**Step 4:** Where there is vacancy and owing to such vacancy the 'ARR – UR' is less than the RER, then 'ARR - UR' computed in step 2 will be treated as GAV.

In nutshell, GAV shall be computed as under

<b>Steps</b>	<b>Particulars</b>	<b>Amount</b>
Ist	<b><u>Compute Reasonable Expected Rent [RER]</u></b> Gross Municipal Value (a) Fair Rent (b) Higher of the (a) and (b) [A]	



2 <sup>nd</sup>	Standard rent (B)	
3 <sup>rd</sup>	Reasonable expected rent [Lower of (A and B)] [C]	
4 <sup>th</sup>	Actual rent received or receivable (ARR) – Unrealised Rent of the current year (UR) [D] Gross annual value Higher of C and D considered as GAV However, where ‘ARR – UR’ is lower due to vacancy, then ‘ARR - UR’ computed in step 2 will be treated as GAV.	

**ILLUSTRATION [COMPUTATION OF REASONABLE EXPECTED RENT]**

Calculate Reasonable Expected Rent from the following details:

Particulars	House 1	House 2	House 3	House 4	House 5
Gross Municipal Value (a)	10,000	12,000	12,000	18,000	16,000
Fair Rent (b)	8,000	16,000	16,000	10,000	17,000
Higher of the [(a) and (b)] [A]	10,000	16,000	16,000	18,000	17,000
Standard Rent as per Rent Control Act [B]	10,000	14,000	N.A	8,000	20,000
Reasonable Expected Rent [Lower of [(A) & (B)]	10,000	14,000	16,000	8,000	17,000

**ILLUSTRATION [WHEN THERE IS NEITHER UNREALISED RENT NOR VACANCY PERIOD]**

Calculate Gross Annual Value for the following house properties. (₹ in ‘000)

Particulars	H1	H2	H3	H4	H5	H6
Gross Municipal value for the whole year	120	130	140	150	160	180
Fair rent for the whole year	105	115	135	155	175	168
Standard rent (for whole year)	NA	100	135	180	165	144
Actual rent receivable	100	110	135	175	200	100
Period of the previous year (in months)	12	12	12	12	12	10

**Solution**

Computation of Gross annual value (GAV)

Step	Particulars	H1	H2	H3	H4	H5	H6
	Calculation of RER						
	Gross Municipal Value (a)	120	130	140	150	160	1501
	Fair Rent (b)	105	115	135	155	175	1401

	Higher of the [(a) and (b)] [A]	120	130	140	155	175	150
	Standard Rent [B]	NA	100	135	180	165	1201
1st	RER [Lower of (A) and (B)]	120	100	135	155	165	120
2nd	ARR	100	110	135	175	200	1001
3rd	<b>Gross Annual Value</b>	120	110	135	175	200	120

1. In case of H6, previous year period is of 10 months, which denotes that construction or acquisition of such house property was completed on 1st of June of the previous year, therefore, Municipal Value, Fair Rent and Standard Rent has been proportionately reduced.

**ILLUSTRATION [WHEN THERE IS UNREALISED RENT BUT NO VACANCY PERIOD]**

Find out the gross annual value in case of the following properties let out throughout the previous year for the assessment year 2019-20.

Particulars	H1	H2	H3	H4	H5
Municipal annual value	90	500	30	100	315
Fair rent	300	300	300	300	300
Standard rent under the Rent Control Act	50	800	240	250	500
Actual rent receivable p.a.	120	600	180	360	150
Unrealised rent of the P.Y. 2018-19 (in terms of months)	2	3	1	3	2

**Solution**

Computation of gross annual value

Step	Particulars	H1	H2	H3	H4	H5
Ist	<b>Calculation of RER</b>					
	Gross Municipal Value	90	500	30	100	315
	Fair Rent	300	300	300	300	300
	Higher of the above [A]	300	500	300	300	315
	Standard Rent [B]	50	800	240	250	500
	Reasonable Expected Rent [lower of A and B] [C]	50	500	240	250	315
IInd	Calculation of (ARR – Unrealised Rent)					
	Actual rent receivable p.a.	120	600	180	360	150
	Unrealised rent	20	150	15	90	25
	ARR – Unrealised Rent [D]	100	450	165	270	125
IIIrd	<b>Gross Annual Value</b> (being higher of step 1 and step 2)	100	500	240	270	315

**ILLUSTRATION [WHEN THERE IS VACANCY PERIOD BUT NO UNREALISED RENT]**

Find out the Gross annual value in case of the following properties

Particulars	H1	H2	H3	H4	H5	H6
Gross Municipal Value p.a.	200	300	400	500	300	300
Fair rent p.a.	300	600	750	180	200	400
Standard rent under the Rent Control Act p.a.	300	180	280	225	250	240
Actual rent p.a.	600	900	300	240	216	240
Property remains vacant (in number of month)	1	3	2	1	2	1

### Solution

Computation of Gross Annual Value

Step	Particulars	Working	H1	H2	H3	H4	H5	H6
1st	Calculation of RER	Higher of GMV and FR (RER cannot exceed SR)	300	180	280	225	250	240
2nd	ARR	For the period actually let out	550	675	250	220	180	220
3rd	Higher of above	Higher of Step 1 & Step 2	550	675	280	225	250	240
4th	Gross Annual Value		550 <sup>1</sup>	675 <sup>1</sup>	250 <sup>2</sup>	220 <sup>2</sup>	250 <sup>3</sup>	220 <sup>4</sup>

### ILLUSTRATION [WHEN THERE IS UNREALISED RENT AS WELL AS VACANCY PERIOD]

Find out the gross annual value in respect of the following properties for the A.Y. 2019-20

Particulars	H1	H2	H3
Gross Municipal value	150	180	120
Fair rent	140	140	240
Standard rent	120	240	300
Actual rent if property is let out throughout the previous year 2018-19	180	300	150
Unrealised rent of the previous year 2018-19	25	40	20
Unrealised rent of the year prior to the previous year 2017-18	30	50	60
Period when the property remains vacant (in number of months)	3	1	-

### Solution

**Working:** Calculation of ARR – Unrealised Rent

$$\mathbf{H1:} [(1,80,000/12) \times 9] - 25,000 = \text{` } 1,10,000$$

$$\mathbf{H2:} [(3,00,000/12) \times 11] - 40,000 = \text{` } 2,35,000$$

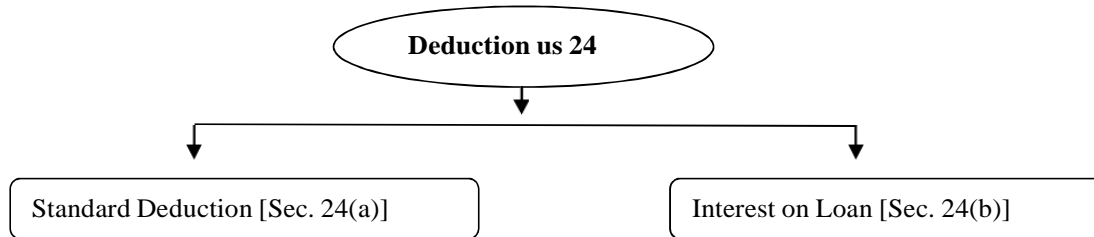
$$\mathbf{H3:} [1,50,000 - 20,000] = \text{` } 1,30,000$$

Computation of Gross Annual Value

Step	Particulars	Working	H1	H2	H3
1st	Calculation of RER	Higher of GMV and FR (RER cannot exceed SR)	120	180	240
2nd	ARR less current year unrealized rent (for let out period only)	Working 1	110	235	130

<b>3rd</b>	Higher of above	Higher of Step 1 & Step 2	120	235	240
<b>4th</b>	<b>Gross Annual Value</b>		110 <sup>1</sup>	235	240 <sup>2</sup>

## DEDUCTIONS U/S 24



The list of deduction u/s 24 is exhaustive i.e., no deduction can be claimed in respect of expenditures which are not specified under this section e.g., no deduction is allowed for repairs, collection charges, insurance, ground rent, land revenue, etc.

### 1. Standard deduction u/s 24(a)

30% of the net annual value is allowed as standard deduction in respect of all expenditures (other than interest on borrowed capital) irrespective of the actual expenditure incurred.

**Note:** Where NAV is negative or zero, standard deduction u/s 24(a) is not available.

### 2. Interest on loan or borrowed capital u/s 24(b)

Interest payable on amount borrowed for the purpose of *purchase, construction, renovation, repairing, extension, renewal or reconstruction* of house property can be claimed as deduction on accrual basis.

### ILLUSTRATION

Following information are provided by an assessee for his house properties for computing interest on loan allowed u/s 24(b):

Particulars	HP1	HP2	HP3	HP4	HP5
Interest on loan taken for repair of H.P.	20,000	30,000	10,000	15,000	25,000
Interest on loan taken for purchasing H.P. (50% paid)	20,000	25,000	30,000	17,000	18,000
Interest on new loan taken for repaying old loan which was taken for purchasing H.P.	10,000	12,000	13,000	14,000	16,000

Interest on loan taken for payment of interest on earlier loan	10,000	10,000	10,000	10,000	10,000
Interest on loan for payment of Municipal tax	2,000	2,000	2,000	2,000	2,000
Interest on loan by mortgaging HP3 for business purpose	--	--	5,000	--	--
Interest on loan for reconstruction of HP1 paid outside India without deducting tax at source	20,000	--	--	--	--
Interest on loan for reconstruction of HP2 payable outside India on which TDS has not been deducted and no payment yet been made	--	20,000	--	--	--
Interest on loan on mortgage of HP1 for renovation of HP2	10,000	--	--	--	--

### Solution

Calculation of 'Interest on loan' allowed u/s 24(b)

Particulars	Note	HP1	HP2	HP3	HP4	HP5
Interest on loan taken for repair of H.P.	Allowed	20	30	10	15	25
Interest on loan taken for purchasing H.P.	1	20	25	30	17	18
Interest on new loan taken for repaying old loan which was taken for purchasing H.P.	Allowed	10	12	13	14	16
Interest on loan taken for payment of interest on earlier loan	Not Allowed	-	-	-	-	-
Interest on loan for payment of Municipal tax	Not Allowed	-	-	-	-	-
Interest on loan by mortgaging HP3 for business purpose	2	-	-	-	-	-
Interest on loan for reconstruction of HP1 paid outside India without deducting tax at source	3	-	-	-	-	-
Interest on loan for reconstruction of HP2 payable outside India on which TDS has not been deducted, and no payment yet made.	4	-	-	-	-	-

Interest on loan on mortgage of HP1 for renovation of HP2	5	-	10	-	-	-
<b>Interest on loan allowed u/s 24(b)</b>		<b>50</b>	<b>77</b>	<b>53</b>	<b>46</b>	<b>59</b>

## RECOVERY OF UNREALISED RENT AND ARREARS RENT [SEC. 25A]

### Applicability

The assessee has received arrears of rent received from a tenant or the unrealised rent realised subsequently from a tenant

### Tax Treatment

The amount so received shall be taxable under the head 'Income from house property' in the year of receipt after deducting standard deduction @ 30% of such amount.

Arithmetically, taxable amount shall be -

$$70\% \times [\text{Recovery of Arrear Rent or Unrealised Rent}]$$

### Taxpoint

- No other deduction shall be allowed from such income except standard deduction i.e. 30% of such receipt. (even legal expenditure shall not be allowed as deduction)
- The income is taxable on cash basis.

**Note:** Such receipt shall be chargeable as income from house property although the assessee is not the owner of such property in the year of receipt.

### ILLUSTRATION

Mr. Lucky Ali owns a house property let out since 1/4/2014 to a school for monthly rent of ₹ 10,000. There was no change in rent till 31/3/2018. On 1/4/2018, as per court decision rent was increased to ₹ 12,000 p.m. with retrospective effect from 1/4/2016 and duly paid by school in the same year. Legal expenditure for such suit has been incurred by Mr. Ali ₹ 30,000. Discuss tax treatment u/s 25A.

### Solution

Arrears rent belongs to the period 1/4/2016 to 31/3/2018 i.e., for 24 months.

Arrears rent received = ` 2,000 × 24 months = ` 48,000

Such rent is taxable in the year of receipt as under:

Particulars	Amount
Arrears of rent received	48,000
Less: Standard deduction u/s 24(a) equal to 30% of such rent	14,400
<b>Income from house property u/s 25A</b>	<b>33,600</b>

**Note:** Legal expenditure is not deductible.

### Illustration

Mr. Krishnan constructed one house in 2016. Half of the portion is let out and the remaining half is used for his residence. particulars are available.

Municipal value	12500
Rent received	10000
Municipal tax	2500
Ground rent	250
Repairs	2000
Interest on loan taken for construction	2500

Compute his income from house property for the AY 2019-20

### Solution

Computation of income from House property		
Let out portion (half)		
Rent received	10000	
Less municipal taxes	<u>1250</u>	
Annual value		8750
Deductions	2625	
30% of annual value	<u>1250</u>	<u>3875</u>
Income from let out portion		4875
Self occupied portion		
Annual value	Nil	
Deductions:		

Interest on loan taken for construction (deduct)	<u>1250</u>	<u>1250</u>
income from house property		<u>3625</u>

### Illustration

Mr. leelamma is the owner of a house in kottayaram. The details regarding her house are given below.

Municipal value	8400
Rent received	9000
Total Municipal tax	1260
Municipal tax paid by tenant	420
Ground rent	250
Repairs	2000
Interest on loan taken for renewing the house	300
Unrealized rent recovered	4000

Compute her income from house property for the AY -2019-20

### Solution

#### Computation of income from house property

Rent received		9000
Less municipal taxes paid by owner		840
Annual value		<b>8160</b>
Deduction: 30% of annual value	2448	
Interest on loan taken for construction	300	2748
Income from the house		5412
Recovery of unrealized rent		4000
Income from house property		<b>9412</b>

### Illustration

Vipin das is the owner of a house in vatakara. It has let out for rent for Rx is fixed as /Rs. 90000 per annum. The municipal tax is fixed as Rs. 10000, which according to agreement is to be paid by the tenant. The owner spent the following amount for providing additional facilities to the tenant.

Water charges	1000
Lift repair	1000
Lighting	800
Gardeners salary	1200

The landlord claims the following deductions

Collection charges	2000
--------------------	------



Land revenue	10000
Repairs	30000
Legal expenses to purchase land	24000

Compute his income from house property 2019-20

**Solution**

Rent received		90000
Less: amenities provided by the owner		
Water	1000	
Lift repair	1000	
Lighting	800	
Gardeners salary	<u>1200</u>	<u>4000</u>
Annual value		86000
Deductions: 30% of annual value		<u>25800</u>
Income from house property		<u><u>60200</u></u>

# MODULE IV

## PROFIT OR GAINS OF BUSINESS OR PROFESSION

### **Business [Sec. 2(13)]**

Business includes –

- Any trade, commerce or manufacture; or
- Any adventure or concern in the nature of trade, commerce or manufacture.

Generally, business means recurring economic activity, but for income tax purpose an isolated activity may be termed as business depending upon facts and circumstances. Following elements shall be considered to judge a transaction as business transaction:

- Nature of commodity      ● Intention of the party      ● Efforts applied in transaction
- Periodicity of transaction      ● Nature of transaction (whether incidental to a business or not)

### **Profession [Sec. 2(36)]**

Profession includes vocation. Profession requires purely intellectual skill or manual skill on the basis of some special learning and qualification gathered through past training or experience e.g. chartered accountant, doctor, lawyer etc. Professional skill can be acquired only after patient study (in a particular system either a college, university or institute) and application (i.e. experience)

Vocation implies natural ability of a person to do some particular work e.g. singing, dancing, etc. The term “vocation” is different from the term “hobby”. Vocation must have the earning feature. It can be treated as an earning means by which a man passes his life. Unlike profession, vocation does not require a degree or special learning.

### **INCOME CHARGEABLE UNDER THE HEAD PROFITS & GAINS OF BUSINESS OR PROFESSION [SEC. 28]**

Sec. 28 enlists the incomes, which are taxable under the head ‘Profits & gains of business or profession’:

- 1. Profits & gains of any business or profession [Sec. 28(i)]:** Any income from business or profession including income from speculative transaction shall be taxable under this head.

**2. Compensation to Management agency [Sec. 28(ii)]:** Any compensation/other payment due to or received

**3. Income of trade or professional association's [Sec. 28(iii)]:** Income derived by a trade, professional or similar association from rendering specific services to its members shall be taxable under this head.

**Note:** This is an exception to the general principle that a surplus of mutual association cannot be taxed.

**4. Export incentive [Sec. 28(iia) (iib) & (iic)]:** An export incentive in form of -

- Profit on sale of import license or duty entitlement pass book. [Sec. 28(iia)/(iic)/(iie)]
- Cash assistance received/receivable by an exporter under a scheme of the Government of India [Sec. 28(iib)]
- Duty draw back (received/receivable) for export e.g. Excise duty drawback, etc. [Sec. 28(iic)]

**5. Perquisite from business or profession [Sec. 28(iv)]:** The value of any benefit or perquisite, whether convertible into money or not, arising from business or profession shall be taxable under this head.

**Examples:** If an authorized dealer of a company receives a car (over and above his commission) from the company on achieving sale-target then market value of such car shall be taxable under the head 'Profits & gains of business or profession'.

**6. Remuneration to partner [Sec. 28(v)]:** Any interest salary, bonus, commission or remuneration received by a partner from the firm (or Limited Liability Partnership) shall be taxable as business income in the hands of the partner to the extent allowed in hands of firm (or Limited Liability Partnership) u/s 40(b).

**7. Amount received or receivable for certain agreement [Sec. 28(va)]:** Any sum, whether received or receivable in cash or in kind, under an agreement for -

- not carrying out any activity in relation to any business or profession; or
- not sharing any know-how, patent, copyright, trade mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provisions for services.

**Exceptions:** The aforesaid provision is not applicable in respect of the following:

a. any sum received or receivable in cash or in kind on account of transfer of the right to manufacture, produce or process any article or thing; or right to carry on any business or profession, which is chargeable under the head Capital gains;

b. any sum received as compensation from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone Layer under the United Nation Environment Programme, in accordance with the terms of agreement (whether or not in writing, whether or not intended to be enforceable by legal proceedings) entered into with the Government of India

**8. Keyman Insurance Policy [Sec. 28(vi)]:** Any sum received under a Keyman Insurance Policy including bonus on such policy. As per sec. 10(10D) Keyman insurance policy is a life insurance policy taken by a person on the life of another person who is or was -

- an employee of the first mentioned person; or
- in any manner whatsoever connected with the business of the first mentioned person.

and includes such policy which has been assigned to a person, at any time during the term of the policy, with or without any consideration

**9. Conversion of stock into capital asset [Sec. 28(via)]:** The fair market value of inventory as on the date on which it is converted into, or treated as, a capital asset.

**10. Recovery against certain capital assets covered u/s 35AD [Sec. 28(vii)]:** Any sum received or receivable (in cash or kind) on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction u/s 35AD.

## **SPECIFIC DEDUCTIONS**

As per sec. 29, income under this head will be computed considering the provisions of sec. 30 to 43DB, which decides the admissibility of expenditures for computing income under this head.

1. Rent, rates, taxes, repairs & insurance for building [sec. 30]

Rent, rates, taxes, repairs & insurance for premises used for the purpose of business or profession shall be allowed under this section.

2. Repairs & insurance of machinery, plant & furniture [sec. 31]

Repairs & insurance of plant, machinery & furniture are allowed as deduction. Points to be noted in this regard:

**a. Use of asset:** The asset must be used for the purpose of business or profession. However, if the asset is not exclusively used for the purpose of business or profession then deduction shall be restricted to a fair proportion of above expenditure, which the Assessing Officer may determine [Sec. 38(2)].

**b. Current repair vs Capital repair:** Only current repairs are allowed as deduction.

**Examples:**

- Heavy expenditure incurred for replacement of part of a ship without creating any asset is deductible
- Any expenditure on the replacement of petrol engine by a diesel engine on his vehicle is allowed u/s 31.

**c. Rent for furniture, plant or machinery:** Only repairs & insurance of machinery, plant & furniture is covered under this section. Rent paid for use of such assets is deductible u/s 37(1)

**3. Depreciation [sec. 32]**

Sec. 32 provides for depreciation on –

Tangible assets	Building, Machinery, Plant and Furniture.
Intangible assets	Know how, Copyright, Trade Mark, Patent, Licence, Franchise, or any other business or commercial right of the similar nature acquired on or after 1/4/1998

**Rules for claiming depreciation**

1. Depreciation is allowed, not on individual assets, but on a block of assets put together collectively. Block of assets means a group of assets which comprises.
  - a. Tangible assets like building, machinery, plant or furniture and
  - b. Intangible assets like know-how patents, copyrights, trade marks, licenses, franchises or any other business or commercial rights of similar nature.

**Block of Assets [Sec. 2(11)]**

Block of assets means a group of assets of same nature, in respect of which same rate of depreciation is charged. In other words, to fall in the same block, the following two conditions are to be satisfied:

- Assets must be of same nature;
- Tangible assets being building, machinery, plant or furniture, and

Intangible assets, being know-how, patents, copy-rights, trade marks, licenses, franchises or any other business or commercial rights of similar nature acquired on or after 1-4-1998;

- Rate of depreciation on such asset must be same.

Rate of depreciation for block of assets-

<b>Block</b>	<b>Nature of Asset</b>
Buildings 5%	Residential building other than hotels and boarding
Buildings 10%	Non residential building, godown, office, factory, etc. including hotels and boarding
Buildings 40%	Temporary construction
Furniture 10%	Any furniture including electrical fittings
Plant/Machinery 20%	Ocean going ships, vessels, speed boats
Plant/Machinery 30%	Motor car (including lorries and buses) used for hiring purposes
Plant/Machinery 40%	Computer including computer software Books owned by a professional
Plant/Machinery 40%	Air or water pollution control equipment
Plant/Machinery 15%	Oil Wells
Plant/Machinery 15%	In general (if nothing is mentioned regarding nature of plant & machinery and including motor car not used for hiring purpose)
Intangible assets 25%	Acquired after 31/3/98

## **Expenditure on Scientific Research (Section 35)**

The term “scientific research” means any activity for the extension of knowledge in the fields of natural or applied sciences including agriculture, animal husbandry or fisheries. The word

Scientific Research has been defined as 'an activity for the extension of knowledge in the fields of natural or applied sciences including agriculture, animal husbandry or fisheries'. Such an activity may result in an improved efficiency and this in turn increases the productivity of the process. So, in order to encourage people to enhance the productivity, government has provided certain tax incentives under this section by way of deduction for expenditure incurred in respect of Scientific Research. Such Scientific research may be carried out for the purpose of

- (a) Extension of business;
- (b) Providing medical facilities to the employees.

Deduction under this section is allowed in two ways

- (A) When assessee takes up scientific research on his own
- (B) When assessee contributes amount for carrying out scientific research to an approved body.

**(A) When assessee takes up scientific research on his own**

When assessee carries on any scientific research, the expenditure incurred by him for such may be

- (a) Revenue expenditure or
- (b) Capital expenditure

The treatment of above is as follows.

**(a) Revenue expenditure**

Any revenue expenditure incurred by the assessee in respect of Scientific research within 3 years immediately preceding the year of commencement of business shall be allowed deduction in the year of commencement. Such revenue expenditure may be in respect of salaries (excluding any perquisites) payable to the staff involved in the research; for acquiring the inputs required to carry out the research or any such eligible expenditure.

**(b) Capital expenditure**

Any Capital expenditure incurred by the assessee is deductible 100% in the year it is incurred.  
Conditions:

- (1) No deduction will be allowed on the capital expenditure incurred on acquisition of land on or after 29/02/1984 whether the land is acquired as such or as a part of property.
- (2) The Capital asset shall be used for the purpose of scientific research only. Any question on the

usage of the asset shall be referred to the Central Government or prescribed authority.

(3) Any Capital expenditure allowed as deduction, if it is not absorbed in the current year, shall be

carried forward for indefinite period, until it is set off.

(4) If any deduction in respect of capital expenditure is claimed under this section, Depreciation under Section 32 cannot be claimed again on the same capital asset.

In these ways, expenditure incurred by the assessee on scientific research carried on by him is deductible. It is worthwhile to mention Section 35(2AB) here.

### **Section 35(2AB): Expenditure on In-house research and development expenses**

(This also comes under (A) Assessee takes up scientific research on his own.) Under this section, a weighted deduction of **2 times** is given to a Company engaged in the manufacture of any article or thing (other than those mentioned in Eleventh Schedule), which incurs any capital or revenue expenditure on In-house research and development facility up to 31/03/2012.

Conditions:

- (1) The assessee who incurs such expenditure shall be a Company
- (2) Capital expenditure in the nature of land or building is not allowed weighted deduction under this section. The cost of building (excluding the cost of land) shall be given deduction of 100% as mentioned in (b) Capital expenditure above.
- (3) To claim this deduction, the company shall enter into an agreement with the prescribed authority for co-operation in the R&D facility and for the audit of accounts of the company.

#### **(B) When assessee contributes amount for carrying out scientific research to an approved body**

A weighted deduction of such amount contributed is given in the following cases.

##### **(1) Amount paid to a University/College/School/Research association:**

Any amount contributed by the assessee to any of the above mentioned institutions shall be given a weighted deduction of **1.75 times**, even if the field of research of such institution is different from that of the assessee.

Conditions:

- (a) Such institution should have 'scientific research' as its main objective.
- (b) Such institution should be approved by the Central Government for this purpose.



**(2) Amount paid to a Company registered in India:**

Any amount contributed by the assessee to a Company registered in India shall be given a weighted deduction of **1.25 times**, even if the field of research of such Company is different from that of the assessee.

Conditions:

- (a) Such Company should have 'scientific research and development' as its main objective.
- (b) Such Company should be approved by the prescribed authority for this purpose.

**(3) Amount paid to a University/College/School/Research association carrying out Social or Statistical research:**

Any amount contributed by the assessee to such institutions shall be given a weighted deduction of **1.25 times**, even if the field of research of such institution is different from that of the assessee.

- (a) Such institution should have 'social or statistical research' as its main objective
- (b) Such institution should be approved by the Central Government for this purpose.

**(4) Amount contributed to National Laboratory [Section 35(2AA)]:**

Any amount contributed by the assessee to a National laboratory\* or University or IIT or to a specified person (approved by prescribed authority) with a specific direction that the amount shall be used for the purpose of scientific research, shall be given a weighted deduction of **2 times**.

\*National Laboratory

Any laboratory functioning at national level under the aegis of

- (1) Indian Council of Agricultural Research
- (2) Indian Council of Medical Research
- (3) Council of Scientific and Industrial Research
- (4) Defence Research and Development Organisation
- (5) Department of Electronics
- (6) Department of Bio-technology
- (7) Department of Atomic Energy

In all the above cases, deduction shall not be denied on the ground that subsequent to such contribution by the assessee, approval granted to the donee has been withdrawn by the prescribed authorities.

## OTHER DEDUCTIONS SECTION 36

Expenses allowable as deduction:

- **Insurance**– This includes insurance premium paid on the following:
  1. **Stock**– this can be claimed as a deduction for businessmen for whom stock-in-trade is of high value and the risk related to stock is high. For example, traders, jewelers etc.
  2. **Cattle**– this insurance premium is paid by a federal milk society on life of cattle.
  3. **Health of employees**– labor forms a significant part of business and many employees take an insurance on the health of their employees. This is allowed as a deduction if it is paid in any mode other than cash. The premium paid can be claimed as a deduction if it is paid to General Insurance Company or any other insurer approved by IRDA.
- **Bonus and commission paid to employees**– This sum is allowed as a deduction if it would not have been paid as dividend or profits. This bonus need not be within the statutory limits specified under Payment of Bonus Acts. It is sufficient if it paid within the time limits. Incentives paid to employees are not covered in this section. However, since it is used for the purpose of Business or Profession, it can be claimed under general deductions section u/s 37.
- **Interest on borrowed capital**– Interest on the amount borrowed for business and profession is allowed as a deduction on payment basis.
  - If the interest is borrowed for acquisition of an asset, the following rule applies:



The interest paid in the above period will not be allowed as a deduction.

- Discount on Zero Coupon Bonds (ZCB)- where the discount will be amortized over the life of the ZCB.

**Employer's contribution to a Recognised Provident Fund or a Superannuation Fund** is allowed as a deduction on payment basis i.e. only in the year in which it is actually paid. This deduction is not on the accrual basis and is on payment basis.

**Employer's contribution to pension fund** specified u/s 80CCD on behalf of his employees – This amount shall be available as a deduction to the extent of 10% of the salary of the employees. Salary includes Dearness Allowance but excludes other perquisites and allowances.

**Employer's contribution to an approved gratuity fund** for benefit of his employees is deductible on payment basis. Likewise, when employees contribute to the gratuity fund and this contribution is deposited by the employer within the stipulated due date it can be claimed as a deduction.

**Animals** used in business when they are not used as stock in trade and they die or become useless, the following amount can be claimed: *Cost of buying the animal – amount realized on sale.*

**Bad debts written off**– This amount can be claimed if the bad debt is incidental to the business and should have been taken into account while computing income. But this shall not include provision created for the same.

Provision for bad debts in case of banks and certain financial institutions- in case of the following banks (scheduled banks, primary agriculture credit society, primary cooperative agriculture bank, rural development bank),

*An amount = 8.5% of gross total income + 10% of aggregate average advances by rural branches shall be allowed as a deduction.*

For banks incorporated outside India and other financial institutions, 5% of the gross total income shall be allowed as a deduction.

The above amount shall be calculated before taking into account any deductions under Chapter VI-A.

- **Special reserve** created by certain entities being, IDFC, Housing Finance Co. etc. and when any profit from an eligible business is transferred to the reserve, it can be claimed as a deduction. This amount of deduction is capped at a maximum of the following:
  - 20% of profits from eligible business
  - Amount transferred < 2 (paid-up capital + general reserves)
  - Eligible business for this purpose includes providing long-term finance for industrial, agricultural, infrastructure and housing development companies.

Further, if the amount transferred to this reserve is withdrawn, it shall be treated as business income in the year of withdrawal.

- Expenses incurred by a company for purpose of **promoting family planning** among employees is allowed as a deduction in the following manner:
  - 1/5th of the amount which is of capital nature is allowed in the year of deduction and the remaining over the succeeding 4 years.

- Any **expenses which are not capital in nature** and is incurred by a corporation or a body corporate (which is established by a Central or a State Act or notified in a Gazette)
- Amount of **banking cash transaction tax** paid by the assessee on taxable banking transaction.
- Contribution to **credit guarantee fund trust** of small-scale industries by a public financial institution.
- Amount paid as **Securities Transaction Tax (STT)** on taxable security transactions and the income relating to this tax should have been included as business income. These transactions must be entered into in the course of business. This means that dealers in stock markets and businesses who undertake trading are eligible for this deduction.
- Amount paid as **Commodities Transaction Tax (CTT)** on taxable commodity transactions and the income relating to this tax should have been included as business income. These transactions must be entered into in the course of business. This deduction is for commodity brokers and dealers.
- Amount of **expenditure incurred by a co-operative society manufacturing sugar, in purchasing sugarcane** when the price paid is less than or equal to the price fixed by the Government.
- **Marked to market loss or other loss** computed in accordance with Income Computation & Disclosure Standards (Ex. mutual funds is an investment which is marked to market).

## **GENERAL DEDUCTIONS [SEC. 37(1)]**

Any expenditure which is not specifically provided in any provisions (discussed earlier) of the Act and fulfills following conditions, shall be allowed as deduction under this section -

1. It must be real and not notional, fictitious or in lieu of distribution of profit.
2. It must be expended wholly & exclusively for the purpose of business or profession carried on by the assessee.
3. It must have been incurred in the previous year.
4. It must not be a personal expenditure.
5. It must not be a capital expenditure.
6. It must be lawful and not have been incurred for any purpose, which is an offence or prohibited, under any law.

## Expenses Disallowed (Section 40)

The following amounts shall not be deducted in computing the income chargeable under the head "profits and gains of business or profession:

- i. Interest, royalty, fees for technical services payable outside India
- ii. TDS not deducted on certain payments:
- iii. Rate or Tax Paid on Profits:
- iv. Wealth Tax [Section 40a(iia)]:
- v. Amount paid by way royalty, license fee, service fee, privilege fee, service charge by State Government undertaking to State Government.
- vi. Salaries [Section 40a(iii)]: Any payment which is chargeable under the head "salaries" if It is payable—
  - a) outside India;
  - b) to a non-resident
- vii. Payment to Provident Funds etc: Any payment to a Provident Fund or other fund established for the benefit of employees of the assessee would be disallowed increases where the assessee (employer) has not made effective arrangements to secure deduction of tax at source from any payment made from the fund which are chargeable to tax under the head 'salaries' in the hands of the employees.
- viii. Payment of tax on non-monetary perquisites [Section 40a(v)]:
- ix. Payment to Partners by a firm (Discussed under the chapter Assessment of firms).
- x. Payment by AOPs / BOIs (Discussed under the chapter assessment of AOP/BOI)

### Illustration

The net profit of business of Mr. Vijayan as disclosed by its profit and loss account were Rs. 325000 after charging the following.

a. Municipal taxes on house property let out	3000
b. Bad debts written off	15000
c. Provision for doubtful debts	16000
d. Provision for taxation	15000
e. Depreciation	25000
f. Depreciation allowable	20000

Ascertain taxable business profit?

### Solution

Net profit	325000
Add:	
Municipal taxes	3000
Provision for bad debts	16000
Provision for taxation	15000

Excess depreciation	5000	<u>39000</u>
Business profit		364000

**Illustration**

The following is the profit and loss account of Mr. raja. You are required to compute his income from business as well as his total income for the assessment year 2019-20.

Salaries and wages	24000	Gross profit	96400
Rent ates and taxes	6400	Dividends	4800
Trade expense	2950	Rent from property	10800
Advt	1900		
Fire insurance premium	600		
Discount	2500		
Postage	550		
Donation	2000		
Income tax	6600		
Loss of stock	4000		
Repairs	1000		
Audit fee	600		
House hold expenses	7000		
Life insurance premium	4000		
Interest on capital	400		
Net profit			
	<u>47550</u>		
	112000		<u>112000</u>

**Solution**

Computation of income from business for the AY 2019-20

Profit as per profit and loss account		47550
Add: expenses disallowed		
Income tax	6600	
Repairs	1000	
Donations	2000	
Interest on capital	400	
Fire insurance	600	
LIC premium	4000	
House hold expenses	<u>7000</u>	<u>21600</u>

		69150
Less:		
Income from property	10800	
Dividend	<u>4800</u>	<u>15600</u>
		53550

Statement of gross total income

Income from house property	10800	
Less: 30% of AV	<u>3240</u>	<u>7560</u>
Income from business		53550
Income from other sources		<u>nil</u>
		<u>61110</u>

*Dividends received from a domestic company are exempted from tax*

**Illustration**

The following is the receipt and payment account maintained by a registered medical practitioner. An abstract of receipts and payments is given below. You are required to compute his income from profession and also compute his total income for the assessment year 2019-20.

Balance b/d	78000	Cost of medicine	8000
Consultation fees	42000	Surgical tools	6000
Sale of medicine	15000	Rent of dispensary	1400
visiting fees	20000	Motor car	100000
interest on govt. securities	3500	Car expense	6000
rent from property	3000	Salaries	5300
loan from bank for pvt use	2000	Life insurance premium	2500
		Interest on bank loan	200
		Property insurance	500
		OYT deposit	8000
		Balance c/d	25600
	<u>163500</u>		<u>163500</u>

Additional information:

1. Half of the motor car expenses are meant for personal use
2. Depreciation allowable on car is 15% and surgical tools @ 25%

**Solution**

Computation of income from profession and house property

Gross professional income		
Sale of medicine	15000	
Visiting fees	20000	
Consultation fee	<u>42000</u>	<u>77000</u>
<b>Less professional expenses:</b>		
Cost of medicine	8000	
Rent of dispensary	1400	
Salaries	5300	
Car expenses –half	3000	
Surgical tools @25%	1500	
Depreciation on car (100000*15/100*1/2)	7500	
OYT deposit	<u>8000</u>	<u>34700</u>
Income from profession		42300
Income from house property	3000	
Less 30% of AV	<u>900</u>	<u>2100</u>
Income from other sources		<u>3500</u>
Gross total income		47900

### **ILLUSTRATION**

Mr. X, a grower and manufacturer of tea, purchased machinery (15%) on 10-04-2017 for ₹ 10 lakh. He computed depreciation for A.Y. 2019-20 as given below; needs your comment on his working:

<b>Particulars</b>	<b>Amount</b>
Opening W.D.V. as on 1/4/2017	Nil
Add: Assets purchased during the year	10,00,000
	<u>10,00,000</u>
Less: Depreciation for the P.Y. 2017-18 [ $10,00,000 \times 15\% \times 40\%$ ]	60,000
(As he is engaged in the business of growing and manufacturing tea; hence 60% is considered as part of agricultural income)	
Opening W.D.V. as on 1/4/2018	9,40,000
Less: Depreciation for the P.Y. 2018-19 [ $9,40,000 \times 15\% \times 40\%$ ]	56,400
Opening W.D.V. as on 1/4/2019	<u>8,83,600</u>

Further, compute his business income for A.Y. 2019-20 assuming that his income before depreciation and without reducing element of agricultural income is ₹ 8,00,000/-



**Solution**

The method of computation of depreciation followed by Mr. X is not correct as Expl. 7 to sec.43(6) provides that:

“Where the income of an assessee is derived, in part from agriculture and in part from business chargeable to income-tax under the head “Profits and gains of business or profession”, for computing the written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire income is derived from the business of the assessee under the head “Profits and gains of business or profession” and the depreciation so computed shall be deemed to be the depreciation actually allowed under this Act.”

The correct computation of depreciation are as follow:

Particulars	Amount
Opening W.D.V. as on 1/4/2017	Nil
Add: Assets purchased during the year	10,00,000
	10,00,000
Less: Depreciation for the P.Y. 2017-18 [ $10,00,000 \times 15\%$ ]	
(Considering the entire income as taxable income)	1,50,000
Opening W.D.V. as on 1/4/2018	8,50,000
Less: Depreciation for the P.Y. 2018-19 [ $8,50,000 \times 15\%$ ]	1,27,500
<b>Opening W.D.V. as on 1/4/2019</b>	<b>7,22,500</b>

Computation of business income of Mr. X for A.Y. 2019-20

Particulars	Amount
Income before depreciation and without reducing element of agricultural income	8,00,000
Less: Depreciation	1,27,500
	6,72,500
Less: Agricultural Income being 60% of above	4,03,500
<b>Profits and Gains of Business or Profession</b>	<b>2,69,000</b>

**Illustration**

From the following figures, you are required to calculate the depreciation admissible during the previous year.

	Plant and machinery	building
Written down value at the beginning of the year	375000	1500000
Purchased during the year	450000	nil
Sales during the year	775000	300000

**Solution**

Calculation of depreciation

	Plant and machinery	Building
WDV at the beginning	375000	1500000
Add: purchase	<u>450000</u>	<u>nil</u>
	825000	1500000
Less: sales	<u>775000</u>	<u>300000</u>
WDV	50000	1200000
Less depreciaton	<u>7500</u>	<u>120000</u>
	<u>42500</u>	<u>108000</u>

# MODULE V

## CAPITAL GAINS

Capital gain shall be taxable in the previous year in which the asset is transferred. However, in some cases, capital gain is taxable in the previous year in which consideration is received rather than in the previous year in which transfer took place e.g. compulsory acquisition by the Government.

### CAPITAL ASSET [SEC. 2(14)]

Capital asset means –

- any kind of property held by an assessee, whether or not in connection with his business or profession;
- any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992.

**Capital asset** may be movable or immovable or tangible/corporeal (furniture, jewellery, etc.) or intangible/ incorporeal (goodwill, tenancy right, copy right, etc.)

---but does not include the following

#### (1) Stock in trade

Stock in trade, consumable stores or raw materials held for business or profession.

However, any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992 shall not be treated as stock-in-trade.

#### (2) Personal effect

Personal effect means any movable property held for personal use of the assessee or for any dependent member of his family but excludes the followings:

- |              |                               |                    |
|--------------|-------------------------------|--------------------|
| a. jewellery | b. archaeological collections | c. drawings        |
| d. paintings | e. sculptures; or             | f. any work of art |

#### (3) Agricultural land in rural area

Agricultural land in **India** is not a capital asset **except** the following –

- a. land which is situated within the jurisdiction of any Municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or by any other name) or Cantonment Board having population of 10,000 or more; or
- b. in any area within the distance, measured aerially

#### **(4) Gold Bonds**

Following gold bonds issued by the Central Government are not capital asset:

- 6.5% Gold Bond, 1977 ● 7% Gold Bonds, 1980; and ● National Defence Gold Bond, 1980

#### **(5) Special Bearer Bond**

Special Bearer Bond, 1991 issued by the Central Government are not capital asset.

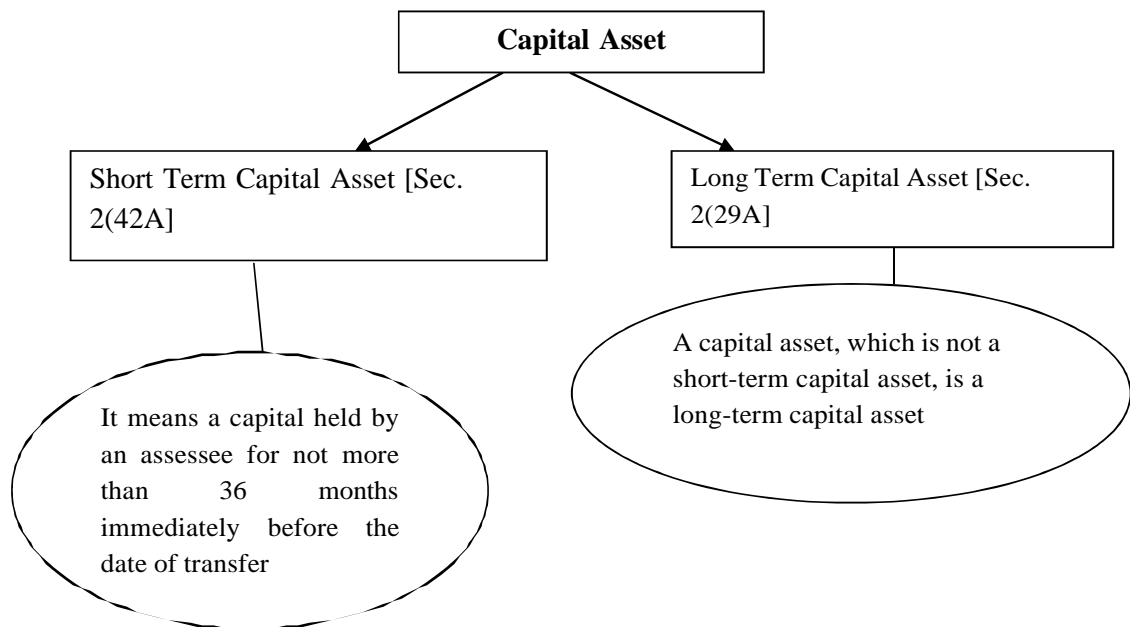
**Note:** It is not necessary that the assessee should be the initial subscriber.

#### **(6) Gold Deposit Bonds**

Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 or deposit certificates issued under the Gold Monetisation Scheme, 2015 notified by the Central Government are not capital asset.

**Note:** Interest on aforesaid bonds or deposits are exempt [Sec. 10(15)]

## TYPES OF CAPITAL ASSET



## TRANSFER [SEC. 2(47)]

Transfer in relation to a capital asset includes:

- (a) Sale, Exchange & Relinquishment of the asset;
- (b) Extinguishment of any right in an asset;
- (c) Compulsory acquisition of an asset under any law;
- (d) Conversion of asset into stock-in-trade by the owner;
- (e) Any transaction of immovable property u/s 53A of the Transfer of Property Act, 1882;
- (f) Any transaction which has the effect of transferring or enabling the enjoyment of any immovable property.
- (g) Maturity or redemption of a zero coupon bond

## TRANSACTIONS NOT REGARDED AS TRANSFER (SEC. 46 & 47)

By virtue of sec. 46(1) and sec. 47 the following *transactions do not constitute transfer for the purpose of capital gain* –

<b>Section</b>	<b>Transaction</b>
46(1)	Any distribution of capital assets in the event of liquidation by a company to its share-holders shall not be treated as transfer in the hands of company.
47(i)	Any distribution of capital assets on the total or partial partition of an HUF.
47(iii)	<i>Any transfer of a capital asset under a gift or will or an irrevocable trust.</i>
	Exception: Gift of shares acquired through Employees Stock Option Plan (ESOP) shall be treated as Transfer
47(iv)	Any transfer of a capital asset by a 100% holding company to its Indian subsidiary company.
47(v)	transfer of a capital asset by a 100% subsidiary company to its Indian holding company
47(vi)	Any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company.
47(via)	Any transfer, in a scheme of amalgamation, of a capital asset being a share or shares held in an Indian company, by the amalgamating foreign company to the amalgamated foreign company, if – a) At least 25% of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and b) Such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated
47(viaa)	Any transfer of a capital asset by a banking company to a banking institution in a scheme of amalgamation of such banking company with such banking institution sanctioned and brought into force by the Central Government u/s 45(7) of the Banking Regulation Act, 1949.
47(viab)	Any transfer, in a scheme of amalgamation, of a capital asset, being a share of a foreign company, (referred to in the Explanation 5 of sec.9(1)(i)), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the amalgamating foreign company to the amalgamated foreign company, if: at least 25% of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and such transfer does not attract tax on capital gains in the country in which the amalga-mating company is incorporated.
47(vib)	Any transfer, in a scheme of demerger, of capital asset by the demerged company to the resulting company, if the resulting company is an Indian company.
47(vic)	Any transfer, in a scheme of demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company, if – The shareholders holding not less than three-fourths in value of the shares of the de-merged foreign company continue to remain shareholders of the resulting foreign company; and Such transfer does not attract tax on capital gain in the country, in which the demerged foreign company is incorporated: <i>Taxpoint:</i> <i>h transfer is in a scheme of demerger by the demerged foreign company to the resulting foreign company.</i>

	<p><i>nsferred asset must be a capital asset being a share or shares held in an Indian company.</i></p> <p><i>reholders holding not less than 75% in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company</i></p> <p><i>h transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated</i></p>
47(vica)	<p><i>any transfer in a business reorganisation, of a capital asset by the predecessor co-operative bank to the successor co-operative bank</i></p>
47(vicb)	<p>Any transfer by a shareholder, in a business reorganisation, of a capital asset being a share or shares held by him in the predecessor co-operative bank if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank</p>
47(vicc)	<p>Any transfer in a demerger, of a capital asset, being a share of a foreign company (referred to in the Explanation 5 of sec. 9(1)(i)), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the demerged foreign company to the resulting foreign company, if:</p> <p>the shareholders, holding not less than 3/4th in value of the shares of the demerged foreign company, continue to remain shareholders of the resulting foreign company; and</p> <p>such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated.</p> <p>Provided that the provisions of sections 391 to 394 of the Companies Act, 1956 shall not apply in case of demergers referred above.</p>
47(vid)	<p>Any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking.</p>
47(vii)	<p>Any transfer by a shareholder, in a scheme of amalgamation, of share(s) held by him in the amalgamating company, if –</p> <p>(a) The transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company except where the shareholder himself is the amalgamated company, and</p>
47(viaa)	<p>Any transfer of a capital asset by a banking company to a banking institution in a scheme of amalgamation of such banking company with such banking institution sanctioned and brought into force by the Central Government u/s 45(7) of the Banking Regulation Act, 1949.</p>
47(viab)	<p>Any transfer, in a scheme of amalgamation, of a capital asset, being a share of a foreign company, (referred to in the Explanation 5 of sec.9(1)(i)), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the amalgamating foreign company to the amalgamated foreign company, if:</p> <p>at least 25% of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and</p> <p>such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated.</p>
47(vib)	<p>Any transfer, in a scheme of demerger, of capital asset by the demerged company to the resulting company, if the resulting company is an Indian company.</p>
47(vic)	<p>Any transfer, in a scheme of demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company, if –</p>

	<p>The shareholders holding not less than three-fourths in value of the shares of the de-merged foreign company continue to remain shareholders of the resulting foreign company; and</p> <p>Such transfer does not attract tax on capital gain in the country, in which the de-merged foreign company is incorporated:</p> <p><i>taxpoint:</i></p> <p><i>Such transfer is in a scheme of demerger by the demerged foreign company to the resulting foreign company.</i></p> <p><i>Transferred asset must be a capital asset being a share or shares held in an Indian company.</i></p> <p><i>Shareholders holding not less than 75% in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company</i></p> <p><i>Such transfer does not attract tax on capital gains in the country, in which the de-merged foreign company is incorporated</i></p>
47(vica)	<p><i>Any transfer in a business reorganisation, of a capital asset by the predecessor co-operative bank to the successor co-operative bank</i></p>
47(vicb)	<p>Any transfer by a shareholder, in a business reorganisation, of a capital asset being a share or shares held by him in the predecessor co-operative bank if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank</p>
47(vicc)	<p>Any transfer in a demerger, of a capital asset, being a share of a foreign company (referred to in the Explanation 5 of sec. 9(1)(i)), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the demerged foreign company to the resulting foreign company, if:</p> <p>the shareholders, holding not less than 3/4th in value of the shares of the demerged foreign company, continue to remain shareholders of the resulting foreign company; and</p> <p>such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated.</p> <p>Provided that the provisions of sections 391 to 394 of the Companies Act, 1956 shall not apply in case of demergers referred above.</p>
47(vid)	<p>Any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking.</p>
47(vii)	<p>Any transfer by a shareholder, in a scheme of amalgamation, of share(s) held by him in the amalgamating company, if –</p> <p>the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company except where the shareholder himself is the amalgamated company, and</p> <p>(b) The amalgamated company is an Indian company.</p>
47(viia)	<p>Any transfer of a capital asset, being foreign currency convertible bonds or Global Depository Receipts referred to in sec. 115AC(1), made outside India by a non-resident to another non-resident.</p> <p><i>Taxpoint:</i></p> <p><i>Transferred asset must be either ‘foreign currency convertible bonds’ or ‘Global Depository Receipts’.</i></p> <p><i>Transfer has been made by a non-resident to another non-resident.</i></p> <p><i>Transfer has been made outside India</i></p>



47(viiaa)	<p>Any transfer, made outside India, of a capital asset being rupee denominated bond of an Indian company issued outside India, by a non-resident to another non-resident</p> <p>Taxpoint: In case of non-resident, any gains arising on account of appreciation of rupee against a foreign currency at the time of redemption of rupee denominated bond of an Indian company held by him, shall be ignored for the purposes of computation of full value of consideration under this section</p>
47(viiab)	<p>Any transfer of a capital asset, being— bond or Global Depository Receipt referred to in sec. 115AC(1); or rupee denominated bond of an Indian company; or derivative, made by a non-resident on a recognised stock exchange located in any International financial Services Centre provided the consideration for such transaction is paid or payable in foreign currency</p>
47(viib)	<p>Any transfer of a capital asset, being a Government Security carrying a periodic payment of interest, made outside India through an intermediary dealing in settlement of securities, by a non-resident to another non-resident</p>
47(viic)	<p>Any transfer of Sovereign Gold Bond issued by the RBI under the Sovereign Gold Bond Scheme, 2015, by way of redemption, by an assessee being an individual</p>
47(ix)	<p>Any transfer of a capital asset being a work of art, archaeological, scientific or art collection, book, manuscript, drawing, painting, photograph or print, to the Government or a University or the National Museum, National Art Gallery, National Archives or any such other public museum or institution as may be notified by the Central Government in the Official Gazette to be of national importance or to be of renown throughout any State or States.</p>
47(x)	<p>Any transfer by way of conversion of bonds or debentures, debenture-stock or deposit certificates in any form of a company into shares or debentures of that company.</p>
47(xa)	<p>Any transfer by way of conversion of bonds referred to in sec. 115AC(1)(a) into shares or debentures of any company.</p>
47(xb)	<p>Any transfer by way of conversion of preference shares of a company into equity shares of that company</p>
47(xii)	<p>Any transfer of a land of a sick industrial company, made under a scheme prepared and sanctioned u/s 18 of the Sick Industrial Companies (Special Provisions) Act, 1985 where such sick industrial company is being managed by its workers' co-operative. Such transfer must have been made during the period commencing from the previous year in which the said company has become a sick industrial company and ending with the previous year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses.</p>
47(xiii)	<p>Any transfer of a capital asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm subject to following conditions:</p> <p>(a) All assets and liabilities of the firm relating to the business immediately before the succession become the assets and liabilities of the company.</p> <p>(b) All the partners of the firm immediately before the succession become the share-holders of the company in the same proportion in which their capital accounts stood in the books of the firm on the date of succession.</p> <p>(c) The partners of the firm do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company; and</p>

	(d) The aggregate of the shareholding in the company of the partners of the firm is not less than 50% of the total voting power in the company and their shareholding continues to be as such for a period of 5 years from the date of succession.
47(xiiia)	Any transfer of a membership right of a recognized stock exchange in India for acquisition of shares and trading or clearing rights in that recognized stock exchange in accordance with a scheme for demutualization or corporatization which is approved by SEBI
47(xiiib)	<p>Any transfer of -</p> <p>a capital asset or intangible asset by a private company or unlisted public company (hereafter referred to as the company) to a limited liability partnership (LLP); or</p> <p><b>b.</b> a share(s) held in the company by a shareholder as a result of conversion of the company into a limited liability partnership (LLP)</p> <p>shall not regarded as a transfer, if following conditions are satisfied:</p> <p>i. All the assets and liabilities of the company immediately before the conversion be-come the assets and liabilities of the LLP;</p> <p>ii. All the shareholders of the company immediately before the conversion become the partners of the LLP and their capital contribution and profit sharing ratio in the LLP are in the same proportion as their shareholding in the company on the date of conversion;</p> <p>iii. The shareholders of the company do not receive any consideration or benefit other than by way of share in profit and capital contribution in the LLP;</p> <p>iv. The aggregate of the profit sharing ratio of the shareholders of the company in the LLP shall not be less than 50% at any time during the period of 5 years from the date of conversion;</p> <p>v. The total sales, turnover or gross receipts in business of the company in any of the 3 previous years preceding the previous year in which the conversion takes place does not exceed ` 60 lakh;</p> <p>vi. The total value of the assets as appearing in the books of account of the company in any of the 3 previous years preceding the previous year in which the conversion takes place does not exceed ` 5 crore; and</p> <p>vii. No amount is paid (directly or indirectly) to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of 3 years from the date of conversion.</p>
47(xiv)	<p>Where a sole proprietary concern is succeeded by a company in the business carried on by it as a result of which the sole proprietary concern sells or otherwise transfers any capital asset to the company, subject to following conditions –</p> <p>(a) All assets and liabilities of the sole proprietary concern relating to the business immediately before the succession become the assets and liabilities of the company;</p> <p>(b) Proprietor holds not less than 50% of the total voting power in the company and his shareholding continues to remain as such for a period of 5 years from the date of succession; and</p> <p>(c) The sole proprietor does not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company.</p>
47(xv)	Any transfer in a scheme for lending of any securities under an agreement or arrangement, which the assessee has entered into with the borrower of such securities and which is subject to the guidelines issued by the SEBI or the RBI.
47(xvi)	Any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government

47(xvii)	Any transfer of a capital asset, being share of a special purpose vehicle (referred to in sec. 10(23FC)) to a business trust in exchange of units allotted by that trust to the transferor.
47(xviii)	<p>Any transfer by a unit holder of a capital asset, being a unit or units, held by him in the consolidating scheme of a mutual fund, made in consideration of the allotment to him of a capital asset, being a unit or units, in the consolidated scheme of the mutual fund.</p> <p>The exemption is available only the consolidation of two or more schemes of equity oriented fund or of two or more schemes of a fund other than equity oriented fund.</p> <p>“Consolidated scheme” means the scheme with which the consolidating scheme merges or which is formed as a result of such merger.</p> <p>“Consolidating scheme” means the scheme of a mutual fund which merges under the process of consolidation of the schemes of mutual fund in accordance with the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 made under the Securities and Exchange Board of India Act, 1992.</p> <p>In the case of a capital asset, being a unit or units, which becomes the property of the assessee in consideration of a transfer referred to in this clause, period of holding shall includes the period for which the unit or units in the consolidating scheme of the mutual fund were held by the assessee.</p>
47(xix)	Any transfer by a unit holder of a capital asset, being a unit or units, held by him in the consolidating plan of a mutual fund scheme, made in consideration of the allotment to him of a capital asset, being a unit or units, in the consolidated plan of that scheme of the mutual fund.

## COMPUTATION OF CAPITAL GAINS [SEC. 48]

**Short-term Capital Gain** means the gain arising on transfer of short-term capital asset [Sec. 2(42B)].

**Long-term Capital Gain** means the gain arising on transfer of long-term capital asset [Sec. 2(29B)].

### Computation of Short Term Capital Gain (STCG)

At a glance, computation of capital gain of \_\_\_\_\_ for the Assessment Year .....

Particulars	Details	Amount
Sale consideration (Full value of consideration)		*****
<i>Less:</i> Expenses on transfer		*****
Net sale consideration		*****
<i>Less:</i> i) Cost of acquisition	*****	
ii) Cost of improvement	****	****
<b>Short Term Capital Gain</b>		_____
<i>Less:</i> Exemption u/s 54B, 54D, 54G, etc.		*****
<b>Taxable Short Term Capital Gain</b>		*****

### **Computation of long term capital gain**

Long term capital gain is computed as below:

Full value of consideration – (indexed cost of acquisition + indexed cost of improvement + cost of transfer).

Where, indexed cost of acquisition = cost x CII of year of transfer CII year of acquisition.

CII = cost of inflation index.

The 'cost of acquisition of capital asset' is to be increased by cost inflation index.

### **COST OF INFLATION INDEX**

Cost inflation index, in relation to a previous year, means such Index as the Central Government may, having regard to 75% of average rise in the Consumer Price Index (urban) for the immediately preceding previous year to such previous year, by notification in the Official Gazette, specify, in this behalf. Cost Inflation Index for different financial years is as follows:

<b>Financial Year</b>	<b>Index</b>	<b>Financial Year</b>	<b>Index</b>
2001-02	100	2011-12	184
2002-03	105	2012-13	200
2003-04	109	2013-14	220
2004-05	113	2014-15	240
2005-06	117	2015-16	254
2006-07	122	2016-17	264
2007-08	129	2017-18	272
2008-09	137	2018-19	280
2009-10	148		
2010-11	167		

Note: Indexed cost of acquisition has to be ascertained with reference to the date of acquisition and not with reference to the date when such asset became a capital asset.

### **COST OF ACQUISITION**

Cost of Acquisition (COA) means any capital expense at the time of acquiring capital asset under transfer, i.e., to include the purchase price, expenses incurred up to acquiring date in the form of registration, storage etc. expenses incurred on completing transfer.

#### **Cost of acquisition is special cases**

1. Where the capital asset became the property of the assessee:

a. on any distribution of assets on the total or partial partition of a Hindu undivided family;

- b. under a gift or will;
- c. by succession, inheritance or devolution;
- d. on any distribution of assets on the dissolution of a firm, body of individuals, or other association of persons, where such dissolution had taken place at any time before 1.04.1987;
- e. on any distribution of assets on the liquidation of a company;
- f. under a transfer to a revocable or an irrevocable trust;
- g. by transfer from its holding company or subsidiary company;
- h. by transfer in a scheme of amalgamation;
- i. by an individual member of a Hindu Undivided Family giving his separate property to the assessee HUF anytime after 31.12.1 969,

In all above cases, the *cost of acquisition of the asset shall be the cost for which the previous owner of the property acquired it*, as increased by the cost of any improvement of the asset incurred or borne by the previous owner or the assessee, as the case may be, till the date of acquisition of the asset by the assessee.

If the previous owner had also acquired the capital asset by any of the modes above, then the cost to that previous owner, who had acquired it by mode of acquisition other than the above, should be taken as cost of acquisition.

2. Where shares in an amalgamated Indian company became the property of the assessee in a scheme of amalgamation the cost of acquisition of the shares of the amalgamated company shall be the cost of acquisition of the shares in the amalgamating company.

3. Where a share or debenture in a company, became the property of the assessee on conversion of bonds or debentures the cost of acquisition of the asset shall be the part of the cost of debenture, debenture stock or deposit certificates in relation to which such asset is acquired by the assessee.

4. Where shares, debentures or warrants are acquired by the assessee under Employee Stock Option Plan or Scheme and they are taken as perquisites u/s 1 7(2) the Cost of Acquisition would be the valuation done u/s 1 7(2).

5. Cost of Acquisition of shares in the Resulting Company, in a demerger.

The cost of acquisition of the original shares held by the share holder in the demerged company will be reduced by the above amount.

6. Where **Capital Gains** is not levied on a transfer of capital asset between a Subsidiary Company and a Holding Company or vice-versa but the conditions laid down are violated subsequently and Capital Gains is to be levied, the cost of acquisition to the transferee company would be the cost for which such asset was acquired by it.

7. Where the capital asset is goodwill of a business or a Trade Mark or Brand Name associated with a business, right to manufacture, produce or process any article or thing, right to carry on any business, tenancy rights, stage carriage permits or loom hours, the cost of acquisition is the purchase price paid by the assessee and in case no such purchase price is paid it is nil.

8. Where the cost for which the previous owner acquired the property cannot be ascertained, the cost of acquisition to the previous owner means the Fair Market Value on the date on which the capital asset became the property of the previous owner.

9. Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation cost of acquisition of such asset is the Fair Market Value of the asset on the date of distribution.

10. Where share or a stock of a company became the property of the assessee on:

**a.** the consolidation and division of all or any of the share capital of the company into shares of larger amount than its existing shares;

**b.** the conversion of any shares of the company into stock;

**c.** the re-conversion of any stock of the company into shares;

**d.** the sub-division of any of the shares of the company into shares of smaller amount; or

**e.** the conversion of one kind of shares of the company into another kind. Cost of acquisition of the share or stock is as calculated from the cost of acquisition of the shares or stock from which it is derived.

11. The cost of acquisition of rights shares is the amount which is paid by the subscriber to get them. In case a subscriber purchases the right shares on renunciation by an existing share holder, the cost of acquisition would include the amount paid by him to the person who has renounced the rights in his favor and also the amount which he pays to the company for subscribing to the shares. The person

who has renounced the rights is liable for **capital gains** on the rights renounced by him and the cost of acquisition of such rights renounced is nil.

**12. The cost of acquisition of bonus shares is nil.**

13. Where equity share(s) are allotted to a share holder of a recognised stock exchange in India under a scheme of demutualisation or corporatisation approved by SEBI, the cost of acquisition of the original membership of the exchange is the cost of acquisition of the equity share(s). The cost of acquisition of trading or clearing rights acquired under such scheme of demutualisation or corporatisation is nil.

14. Where any other capital asset has become the property of the assessee before 1st day of April, 1981, the cost of acquisition of the asset to the assessee or the previous owner (depending upon the mode of acquisition) or the fair market value of the asset on 1.4.1981, at the option of the assessee would be its cost of acquisition.

15. Where the capital gain arises from the transfer of specified security or sweat equity shares, the cost of acquisition of such security or shares shall be the fair market value which has been taken into account while computing the value of the respective fringe benefit.

16. Where the capital asset, being a share or debenture of a company, became the property of the assessee in consideration of transfer of bonds or debentures or Global Depository Receipts purchased in foreign currency, the cost of acquisition shall be deemed to be that part of the cost of debentures or bond or deposit certificate in relation to which such asset is acquired by the assessee.

**Cost of improvement**

Cost of improvement is the capital expenditure incurred by an assessee for making any addition or improvement in the capital asset. It also includes any expenditure incurred in protecting or curing the title. In other words, cost of improvement includes all those expenditures, which are incurred to increase the value of the capital asset. However, any expenditure which is deductible in computing the income under the heads Income from House Property, Profits and Gains from Business or Profession or Income from Other Sources (Interest on Securities) would not be taken as cost of improvement.

## **EXEMPTED LONG TERM CAPITAL GAIN**

### **1. Transfer Of A Residential House And Investment In One Residential House**

When an individual sells a residential property and buys another residential property, he will be eligible for exemption under Section 54. Conditions to avail the benefit of exemption under Section 54 includes:

- The taxpayer (ie. seller) needs to be an individual or HUF. Thus, firms, LLP's and companies cannot utilize the benefits of this section.
- Asset needs to be classified as a long-term capital asset.
- The asset sold is a Residential House. Income from such a house should be chargeable as Income from House Property
- The seller should purchase a residential house either 1 year before the date of sale/transfer or 2 years after the date of sale/transfer. In case the seller is constructing a house, the seller has an extended time, ie. the seller will have to construct the residential house within 3 years from the date of sale/transfer. In case of compulsory acquisition, the period of acquisition or construction will be determined from the date of receipt of compensation (whether original or additional compensation)
- The new residential house should be in India. The seller cannot buy or purchase a residential house abroad and claim the exemption.

### **2. Transfer of agricultural lands (Section 54B)**

A farmer wants to shift his agricultural land for certain reason and hence he sold his old agricultural land and from the sale proceeds he purchased another agricultural land. In this case the objective of the seller was not to earn income by sale of old land but was to shift to another land. If in this case, the seller was liable to pay income-tax on capital gains arising on sale of old land, then it would be a hardship on him.

Section 54B gives relief from such a hardship. Section 54B gives relief to a taxpayer who sells his agricultural land and from the sale proceeds he acquires another agricultural land. The detailed provisions in this regard are discussed in this part.

#### **Basic conditions**

Following conditions should be satisfied to claim the benefit of section 54B.

- The benefit of section 54B is available only to an individual or a HUF



- The asset transferred should be agricultural land. The land may be a long-term capital asset or short-term capital asset.
- The agricultural land should be used by the individual or his parents for agricultural purpose at least for a period of two years immediately preceding the date of transfer. In case of HUF the land should be used by any member of HUF.
- Within a period of two years from the date of transfer of old land the taxpayer should acquire another agricultural land. In case of compulsory acquisition the period of acquisition of new agricultural land will be determined from the date of receipt of compensation. However, as per section 10(37), no capital gain would be chargeable to tax in case of an individual or HUF if agricultural land is compulsorily acquired under any law and the consideration of which is approved by the Central Government or RBI and received on or after 01-04-2004.

### **3. Compulsory acquisition of land and building of industrial undertakings (54D)**

To get exemption the following conditions are to be satisfied:

1. There must be compulsory acquisition.
2. The property compulsorily acquired should be land and building forming part of an industrial undertaking.
3. The asset must have been used in the 2years immediately preceding the date of transfer of the assessee for the purpose of the business of the undertaking.
4. Within a period of 3 years after the date of compulsory acquisition any other land or building should be purchased or constructed for the use of existing or newly set up industrial undertaking.

### **4. investment in financial asset (Section 54 EC)**

This exemption is available to all categories of taxpayers. To get exemption the following condition are to be satisfied.

1. The asset transferred should be a long- term capital asset
2. Within a period of 6 months after the date of transfer, the capital gain must he invested in the specified assets i.e. bonds redeemable after 3 years issued by NHA1 or RECL.

### **5. Capital gains invested in units of notified land for financing start up (Section 54EE)**

**54EE.** (1) Where the capital gain arises from the transfer of a long-term capital asset (herein in this section referred to as the original asset) and the assessee has, at any time within a period of six

months after the date of such transfer, invested the whole or any part of capital gains in the long-term specified asset, the capital gain shall be dealt with in accordance with the following provisions of this section, namely:—

(a) if the cost of the long-term specified asset is not less than the capital gain arising from the transfer of the original asset, the whole of such capital gain shall not be charged under section 45;

(b) if the cost of the long-term specified asset is less than the capital gain arising from the transfer of the original asset, so much of the capital gain as bears to the whole of the capital gain the same proportion as the cost of acquisition of the long-term specified asset bears to the whole of the capital gain, shall not be charged under section 45:

#### **6. Investment into one residential house (Section 54F)**

As per provisions of section 54F of the Income Tax Act, 1961, exemption of capital gain is available in case of transfer of long term capital assets against investment in residential house. The salient features for availing exemption under section 54F are detailed hereunder –

1. The exemption under section 54F is available only to individual and HUF;
2. Capital gain has arisen on account of transfer of any long term capital assets other than residential house;
3. Net consideration arisen on account of transfer of long term capital assets has been invested as follows –

Net consideration has been re-invested in purchase of one residential house within a period of 1 year before the date of transfer or within a period of 2 years after the date of transfer; or

Net consideration has been re-invested in construction of one residential house in India within a period of 3 years from the date of transfer.

#### **7. Transfer of fixed asset of industrial undertaking effected to shift it from urban area – 54G**

Exemption is Allowed provided the Assessee has Capital Gains in connection with shifting of Industrial Undertaking from Urban area to any other area.

*The conditions for claiming exemptions are as under:*

- i. the transfer is effected in the course of or in consequence of shifting the undertaking from an urban area to any other area. Any other area means an area not declared as an urban area.

'Urban area' means any such area within the limits of a municipal corporation or municipality, as the Central Government may, having regard to the population, concentration of industries, need for proper planning of the area and other relevant factors, by general or special order, declare to be an urban area for the purposes of this sub-section;

- ii. asset transferred is machinery, plant, building, land or any right in building or land used for the business of industrial undertaking in an urban area;
- iii. the capital gain arising on the asset transferred may be short-term or long-term capital gain. Normally, it will be short-term capital gain because most of the assets of the industrial undertaking will be depreciable assets;
- iv. the capital gain is utilised within one year before or 3 years after the date of transfer for the specified purpose.

**8. Shifting of an industrial undertaking from urban area to any special economic zone (section 54GA).**

Section 54GA. (1) Notwithstanding anything contained in section 54G, where the capital gain arises from the transfer of a capital asset, being machinery or plant or building or land or any rights in building or land used for the purposes of the business of an industrial undertaking situate in an urban area, effected in the course of, or in consequence of the shifting of such industrial undertaking to any Special Economic Zone, whether developed in any urban area or any other area and the assessee has within a period of one year before or three years after the date on which the transfer took place,-

(a) purchased machinery or plant for the purposes of business of the industrial undertaking in the Special Economic Zone to which the said undertaking is shifted;

(b) acquired building or land or constructed building for the purposes of his business in the Special Economic Zone;

(c) shifted the original asset and transferred the establishment of such undertaking to the Special Economic Zone; and

(d) incurred expenses on such other purposes as may be specified in a scheme framed by the Central Government for the purposes of this section, then, instead of the capital gain being charged to income-tax as income of the previous year in which the transfer took place, it shall, subject to the provisions of sub-section (2), be dealt with in accordance with the following provisions of this section, that is to say,-

(i) if the amount of the capital gain is greater than the cost and expenses incurred in relation to all or

any of the purposes mentioned in clauses (a) to (d) (such cost and expenses being hereafter in this section referred to as the new asset), the difference between the amount of the capital gain and the cost of the new asset shall be charged under section 45 as the income of the previous year; and for the purpose of computing in respect of the new asset any capital gain arising from its transfer within a period of three years of its being purchased, acquired, constructed or transferred, as the case may be, the cost shall be Nil; or

(ii) if the amount of the capital gain is equal to, or less than, the cost of the new asset, the capital gain shall not be charged under section 45, and for the purpose of computing in respect of the new asset any capital gain arising from its transfer within a period of three years of its being purchased, acquired, constructed or transferred, as the case may be, the cost shall be reduced by the amount of the capital gain.

Explanation.-In this sub-section,-

(a) "Special Economic Zone" shall have the meaning assigned to it in clause (za) of \*[section 2 of] the Special Economic Zones Act, 2005;

(b) "urban area" means any such area within the limits of a municipal corporation or municipality as the Central Government may, having regard to the population, concentration of industries, need for proper planning of the area and other relevant factors, by general or special order, declare to be an urban area for the purposes of this sub-section.

(2) The amount of capital gain which is not appropriated by the assessee towards the cost and expenses incurred in relation to all or any of the purposes mentioned in clauses (a) to (d) of sub-section (1) within one year before the date on which the transfer of the original asset took place, or which is not utilised by him for all or any of the purposes aforesaid before the date of furnishing the return of income under section 139, shall be deposited by him before furnishing such return [such deposit being made in any case not later than the due date applicable in the case of the assessee for furnishing the return of income under sub-section (1) of section 139] in an account in any such bank or institution as may be specified in, and utilised in accordance with, any scheme which the Central Government may, by notification, frame in this behalf and such return shall be accompanied by proof of such deposit; and, for the purposes of sub-section (1), the amount, if any, already utilised by the assessee for all or any of the aforesaid purposes together with the amount so deposited shall be deemed to be the cost of the new asset :

Provided that if the amount deposited under this sub-section is not utilised wholly or partly for all or any of the purposes mentioned in clauses (a) to (d) of sub-section (1) within the period specified in that sub-section, then,-

- (i) the amount not so utilised shall be charged under section 45 as the income of the previous year in which the period of three years from the date of the transfer of the original asset expires; and
- (ii) the assessee shall be entitled to withdraw such amount in accordance with the scheme aforesaid.

## **9. Exemption of long term capital gains tax on transfer of residential property (S 54GB)**

**Eligible Assessee** – Individual and HUF

**Eligible Capital Gain** – Capital gain arising from transfer of **long term** capital asset being a residential house or a plot of land. Transfer of such capital asset should take place between 1<sup>st</sup> April, 2012 and 31<sup>st</sup> March, 2017.

**Condition for exemption** – The assessee has before the due date of furnishing return of income utilizes the net consideration for subscription in equity shares in an eligible company. The eligible company should utilize this amount for purchase of an eligible asset within one year from the date of such subscription. If such company not fully or partially utilizes this amount within one year then such unutilized amount is taxable as capital gain in the year in which such limit of one year expires.

## **10. Section 54H of Income Tax Act "Extension of time for acquiring new asset or depositing or investing amount of capital gain"**

Section 54H. Notwithstanding anything contained in sections 54, 54B, 54D, 54EC and 54F, where the transfer of the original asset is by way of compulsory acquisition under any law and the amount of compensation awarded for such acquisition is not received by the assessee on the date of such transfer, the period for acquiring the new asset by the assessee referred to in those sections or, as the case may be, the period available to the assessee under those sections for depositing or investing the amount of capital gain in relation to such compensation as is not received on the date of the transfer, shall be reckoned from the date of receipt of such compensation :

Provided that where the compensation in respect of transfer of the original asset by way of compulsory acquisition under any law is received before the 1st day of April, 1991, the aforesaid period or periods, if expired, shall extend up to the 31st day of December, 1991.

## **Capital gain in exceptional cases**

We have already discussed the general rules of computing taxable capital gains in the preceding paragraphs. There are, however, certain situations requiring special treatment. Law dealing with such situations is given below.

1. Transfer of shares or debentures of an Indian company by non residents.
2. Transfer of capital assets by a partner to a firm or by a member to association of persons.
3. Compulsory acquisition of assets under any law.
4. Transfer of depreciable assets.
5. Slump date.

### Losses under the head capital gain

Where the assessee has suffered loss on transfer of certain capital asset and earned profit on transfer of other assets, he is entitled to set off such losses against such gains. Any loss remaining unadjusted under the head capital gain however, cannot be set off against income under the other heads, eg, salaries, house property, business or profession and other sources. But it shall be carried forward for set off against capital gains in the subsequent assessment years. However, no loss shall be carried forward for more than eight assessment years from the year for which the loss was computed.

#### ILLUSTRATION

Mr. Divesh had purchased a golden ring as on 17/8/2017 for ₹ 20,000. On 1/05/2018, he has sewn a diamond on it costing ₹ 25,000. On 1/08/2018, he sold such ring for ₹ 80,000 and incurred brokerage for arranging customer ₹ 5,000. Compute capital gain.

#### Solution

Computation of capital gain of Mr. Divesh for the A.Y.2019-20

Particulars	Details (₹)	Amount (₹)
Sale consideration		80,000
<i>Less: Expenses on transfer</i>		5,000
Net sale consideration		75,000
<i>Less: i) Cost of acquisition</i>	20,000	
ii) Cost of improvement	25,000	45,000
<b>Short Term Capital Gain</b>		<b>30,000</b>

#### ILLUSTRATION

On 23rd December, 2018, Rajat sold 500 grams of gold, the sale consideration of which was ₹ 13,50,000. He had acquired this gold on 20th August, 2000 for ₹ 4,00,000. Fair market value of 500 grams of gold on 1st April, 2001 was ₹ 3,60,000. Find out the amount of capital gain chargeable to tax for the assessment year 2019-20.

### Solution

Computation of capital gains of Rajat for the A.Y. 2019-20

Particulars	Working	Amount
Sale consideration		13,50,000
Less: Expenses on transfer		Nil
Net Sale consideration		13,50,000
Less: Indexed cost of acquisition	$\frac{4,00,000}{280} \times 100$	11,20,000
<b>Long term capital gain</b>		<b>2,30,000</b>

If an asset is acquired before 1/4/2001 then its cost of acquisition will be higher of the following:

- a) Actual cost of acquisition; or b) Fair market value of the asset as on 1/4/2001

### Illustration

Mr. bal Krishnan provides you the following information relating to the sale of his only residential house. Calculate his capital gain for the assessment year 2019-20.

Sold the house in Sept 2018	5000000
Expenditure incurred in connection with transfer	25000
House purchased in January 1987	240000
Fair market value on Ist may 2001	420000
Purchased another residential house in January 2019	1050000
Invested in bond issued by NHA u/s 54EC in jan 2019	850000
The cost of inflation index in 2001-02 was 100 and for 2018-19	280

### Solution

Calculation of capital gains for the assessment year 2019-20

Sale of house in September 2018	5000000
Less: expenses of sale	25000
	-----
Net sales consideration	4975000
Less: indexed cost of acquisition $\frac{420000}{100} \times 280$	<u>1176000</u>
Capital gain	3799000
Less: exemption u/s 54 being the cost of house	
Purchased within one year	<u>1050000</u>
	2749000
Less: exemption u/s 54EC	<u>850000</u>
	1899000

**illustration**

Mr. A sold his property for Rs. 376000 in December 2018 incurring an expense of Rs. 6000 which was purchased in January 2017 for Rs. 240000. Find out taxable capital gain ?

**Solution**

Here the capital gain is short term

Sale of property	376000
Less: expenses	<u>6000</u>
	370000
Less: cost	<u>240000</u>
Taxable capital gain	130000

**Illustration**

Calculate capital gain from the following data. Sold self generated goodwill for a business RS. 700000 bonus shares in kairali ltd (not listed) and (being short term capital assets) sold for RS. 400000. Business income Rs. 30000. Long term capital loss in the transfer of a building Rs. 20000. Face value of bonus shares sold RS. 300000.

**Solution**

## Computation of capital gain

<b>Calculation of long term capital gain</b>	
Selling price of self generated goodwill	700000
Less: cost	Nil
Long term capital gain	700000
Less: long term capital loss on building	20000
Long term capital gain	680000
<b>Calculation of short term capital gain</b>	
Selling price of bonus shares	400000
Less: cost	Nil
Short term capital gain	400000
Taxable capital gain	680000+400000=1080000



## **INCOME FROM OTHER SOURCES**

As per sec. 56(1), any income, which is not specifically exempted and not chargeable under any other heads of income, shall be chargeable under the head "Income from other sources". This is the last and residuary head of income.

**Sec. 56(2) lays down the list of incomes, which are specifically taxable under this head:**

### **Income absolutely chargeable under this head**

1. Dividends [Sec. 56(2)(i)]
2. Casual income e.g. Winning from lotteries, etc. [Sec. 56(2)(ib)]
3. Gift [Sec. 56(2)(x)]
4. Share premium in excess of fair market value of shares [Sec. 56(2)(viib)]
5. Income by way of interest received on compensation or on enhanced compensation [Sec.56(2)(viii)]
6. Sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if:
  - (a) such sum is forfeited; and
  - (b) the negotiations do not result in transfer of such capital asset [Sec. 56(2)(ix)] [Discussed in Capital Gain]

### **Income chargeable under this head if not charged under the head 'Profits and gains of business or profession'**

7. Any sum received by the assessee from his employees as contribution to provident fund, etc. [Sec. 56(2)(ic)]
8. Interest on securities [Sec. 56(2)(id)] [discussed later]
9. Income from letting of machinery, plant or furniture [Sec. 56(2)(ii)] [discussed later]
10. Composite Rent [Sec. 56(2)(iii)] [discussed later]

### **Income chargeable under this head if not charged under the head 'Profits and gains of business or profession' or under the head 'Salaries'-**

11. Any sum (including bonus) received under a Keyman Insurance Policy [Sec. 56(2)(iv)] Keyman Insurance Policy means a life insurance policy taken by a person on the life of another person, who is either the employee or is connected in any manner with the business of the former person [Explanation to Sec. 10(10D)]

12. Any compensation or other payment, due to or received by any person, in connection with the termination of his employment or the modification of the terms and conditions relating thereto.  
[Sec. 56(2)(xi)]

**Apart from above, the following incomes are also chargeable under this head by virtue of sec. 56(1). In this regard it is to be noted that the following list is merely indicative and not exhaustive.**

1. Income from sub-letting of a house property.
2. Interest on bank deposits.
3. Interest on company deposits, interest on loans, etc.
4. Remuneration received from a person other than his employer for evaluation of answer scripts.  
However, if such remuneration is received from employer, then the same will be taxable under the head "Salaries".
5. Rent from a vacant land.
6. Insurance commission.
7. Income from undisclosed sources
8. Income from private tuition.
9. Interest on income tax refund.
10. Family pension received by the family members of a deceased employee [discussed later]
11. Dividend received from a co-operative society.
12. Directors' sitting fee for attending Board Meetings.
13. Income from activity of owning and maintaining race-horses.
14. Stipend to trainee.
15. Interest on employee's contribution towards unrecognized provident funds at the time of payment of lump sum amount

### **DIVIDEND [SEC. 2(22)]**

Dividend, in general, means the amount received by a shareholder (whether in cash or in kind) in proportion to his shareholding in a company whether out of past or present income; or taxable or exempted income; or revenue or capital income. However, the Income-tax Act gives an inclusive definition of dividend.

As per sec. 2(22), the following payments or distributions by a company to its shareholders are deemed as dividends to the extent of accumulated profits of the company:

- a) Any distribution of accumulated profits (whether capitalized or not), which results in the release of assets of the company [Sec. 2(22)(a)]

#### **Notes**

- 1. Treatment of bonus share:** Bonus share declared by the company to its equity share-holders shall not be treated as dividend as there is no release of asset.
- 2. Valuation:** In case of release of asset other than cash, the market value of the asset and not the book value shall be considered as deemed dividend in the hands of shareholder.
- 3. Exception:** Above provision is not applicable in case of amalgamation

### **INTEREST ON SECURITIES [SEC. 56(2)(id)]**

As per sec. 2(28B), “interest on securities” means -

- a) Interest on any security of the Central Government or a State Government;
- b) Interest on debentures or other securities issued by or on behalf of -
  - a local authority; or
  - a company; or
  - a corporation established by a Central, State or Provincial Act.

### **Bond Washing Transactions [Sec. 94(1)]**

Interest on securities shall not accrue on day-to-day basis. It accrues on the due date of interest as prescribed by issuing authority. Entire interest shall be charged in the hands of assessee who holds security on such date (irrespective of the date of acquisition of such security). Tax liability may be evaded by transferring securities just before the due date of interest (interest includes dividend) to any person (like friend or relative who has low income) and reacquiring the same, after the interest is received by the transferee. With this practice, income, which should have been charged at higher rate, shall be charged at lower rate or nil rates. To avoid these practices, sec. 94(1) provides that -

where an assessee transfers the securities before the due date of interest and reacquires the same, then the interest received by the transferee will be deemed to be the income of the transferor.

E.g: Mr. X transferred 1,000 10% debentures (due date of interest of such debenture is 31st March every year), to his brother Mr. Y on 27/03/2019 to evade tax. Such security is repurchased by him

on 5/04/2019. Interest for the previous year 2018-19, though received by Mr. Y shall be taxable in hands of Mr. X due to sec. 94(1).

## Deduction of tax at source

The person who is responsible for paying income by way of interest on securities shall at the time of payment, deduct income tax at the rate in force on the amount of interest payable. The person or comp[any who deduct tax is required to deposit such amount of tax deducted to the government treasury on behalf of the assessee. This is known as deduction of tax at source.

Tax need not be deducted at source in the following cases.

1. Notified bonds and securities issued by the state and central government.
2. 7 year national saving certificate
3. Debentures issued by cooperative society or public sector company or any authority or any other institution notified by the central government.
4. Interest received from debentures or securities and the total amount of interest payable does not exceed Rs. 5000.
5. Interest received from bank should not exceed RS. 10000
6. No tax shall be deducted if winning from lottery. Cross puzzles, card game and TV game do not exceed rs.10000 and winning from horse races do not exceed Rs. 10000.
7. No tax should be deducted from interest paid if interest payable in financial year do not exceeds Rs. 10000 in case of banks, post office and co operative society and Rs. 50000 in the case of others.
8. Tax shall not deducted at source on interest on savings taxable bonds, 2003 if the intrest payable does not exceeds Rs. 10000 during the year.

### Deductions [Sec. 57]:

The following expenditures are allowed as deductions from income chargeable to tax under the head 'Income from Other Sources':

S.N.	Section	Nature of Income	Deductions allowed
1.	<u>57(i)</u>	Dividend or Interest on securities	Any reasonable sum paid by way of commission or remuneration to banker or any other person for purpose of realizing dividend (other than dividends referred to in <u>section 115-O</u> ) or interest on securities
2.	<u>57(ia)</u>	Employee's contribution towards Provident Fund, Superannuation Fund, ESI Fund or any other fund setup for the welfare of such employees	If employees' contribution is credited to their account in relevant fund on or before the due date

3.	<u>57(ii)</u>	Rental income letting of plant, machinery, furniture or building	Rent, rates, taxes, repairs, insurance and depreciation etc.
4.	<u>57(ia)</u>	Family Pension	1/3 <sup>rd</sup> of family pension subject to maximum of Rs. 15,000.
5.	<u>57(iii)</u>	Any other income	Any other expenditure (not being capital expenditure) expended wholly and exclusively for earning such income
6.	<u>57(iv)</u>	Interest on compensation or enhanced compensation	50% of such interest (subject to certain conditions)
7.	<u>58(4)</u> Proviso	Income from activity of owning and maintaining race horses.	All expenditure relating to such activity.

**Expenses not deductible [Section 58]**

S.N.	Section	Nature of Income
1.	<u>58(1)(a)(i)</u>	Personal expenses
2.	<u>58(1)(a)(ii)</u>	Interest chargeable to tax which is payable outside India on which tax has not been paid or deducted at source
3.	<u>58(1)(a)(iii)</u>	'Salaries' payable outside India on which no tax is paid or deducted at source
4.	<u>58(1A)</u>	Wealth-tax
5.	<u>58(2)</u>	Expenditure of the nature specified in <u>section 40A</u>
6.	<u>58(4)</u>	Expenditure in connection with winnings from lotteries, crossword puzzles, races, games, gambling or betting

**INTEREST EXEMPTED**

The following interest income is exempt from income tax

1. Interest on notified securities, bonds, certificates, deposits, etc
2. Interest on notified capital investment bonds
3. Interest on notified relief bonds
4. Interest on notified bonds in the hands of non residents
5. Interest on non-resident account in the hands of non-resident Indian in any bank in India in accordance with the provisions of the foreign exchange regulation Act 1973.
6. Interest on notified savings certificate
7. Interest on gold deposit bonds, 1999 or deposit certificate under gold monetization scheme 2015.
8. Dividend from domestic company:- any income by way of dividend from a domestic company shall be exempt.

**Illustration**

Compute income from "income from other sources" from the following particulars submitted by Mr. soman.

1. Dividend (gross)	9600
2. Expenses incurred for its collection	500
3. Receipt from letting of plant and machinery	10000
4. Repairs of plant and machinery	4000
5. Insurance premium in respect of plant and machinery	2000
6. Depreciation allowed for letting	4000

### Solution

#### Computation of income from other sources

Receipts from letting of plant and machinery	10000
Less: admissible expenses	
Repairs of plant and machinery	4000
Insurance premium in respect of plant and machinery	2000
Depreciation allowed for letting	<u>4000</u> 10000
Income from other sources	nil

### Illustration

Mr. vasu received the following incomes during 2018-19. Compute taxable income under the head income from other sources separately for each case.

A. 1. Winning from Sikkim lottery (net)	14000
2. winning from horse race	2000
3. winning from crossword puzzle	7000
B. 1. Winning from lottery	2000
2. winnings from horse race	22400

### Solution

A. 1. Winning from lottery $14000 \times 100/70$	20000
2. winning from horse race	2000
3. winning from crossword puzzles $7000 \times 100/70$	<u>10000</u>
Income from other sources	32000
B. 1. winning from lottery	2000
2. winning from horse race $22400 \times 100/70$	<u>32000</u>
Income from other sources	<u>34000</u>
Total	66000

